Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1997

MERRILL LYNCH, PIERCE, FENNER & SMITH INC., LARRY H. LOVITSCH and THOMAS R. VALAIKA,

Petitioners,

v.

MARCIA M. ROUBIK,

Respondent.

On Petition For A Writ Of Certiorari
To The Supreme Court Of Illinois

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Supreme Court of Illinois can review *de novo* an arbitrator's decision on a merits-related issue of the availability of punitive damages, especially when the arbitrating parties affirmatively requested an arbitral decision on that merits-related issue as part of the arbitration of the underlying dispute?

2. Can the Illinois Supreme Court determine whether the parties to an arbitration "clearly and unmistakably" intend that an arbitration panel decide the availability of punitive damages merely from an examination of the "four corners" of their arbitration agreement, without also reviewing the parties' conduct in the arbitration, including their request for an arbitral decision on punitive damages during the course of the arbitration?

3. Whether the Supreme Court of Illinois erred by applying a change in controlling law governing a merits-related issue of an arbitrable claim to vacate a private arbitration award which was issued before the change in law occurred?

4. Can the Illinois Supreme Court compel further arbitration hearings to consider punitive damages through its exercise of *de novo* review to partially vacate an arbitration award, when the arbitration panel permanently adjourned more than five years earlier after having rendered its full and final award which included a denial of punitive damages?

LIST OF PARTIES

Petitioners:

Merrill Lynch, Pierce, Fenner & Smith Inc., a wholly owned subsidiary of Merrill Lynch & Co., Inc. and is the parent corporation for the following non-wholly owned subsidiaries:

Broadcort Capital Corp.

Merrill Lynch & Co., Canada Ltd.
Merrill Lynch Canada Inc.

Merrill Lynch Professional Clearing Corp.

Merrill Lynch Life Agency Inc.*

Thomas R. Valaika

Larry H. Lovitsch

Respondent:

Marcia Roubik

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* Similarly named affiliates and subsidiaries that engage in the sale of life insurance and annuity products are incorporated in various other jurisdictions.

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OPINIONS BELOW

The opinion of the Illinois Supreme Court is reported at 181 Ill. 2d 373, 692 N.E.2d 1167, 230 Ill. Dec. 1 (1998), and is reprinted in full in the Appendix to this Petition. (App. 1-24.) The decision of the Illinois Appellate Court for the First District, Third Division is reported at 225 Ill. App. 3d 217, 220 Ill. Dec. 764, 674 N.E.2d 35 (1st Dist. 1996), and is reprinted in full in the Appendix to this Petition. (App. 26-33.) The order of the Hon. Dorothy K. Kinnaird of the Circuit Court of Cook County is unpublished, but a copy of her written order of July 22, 1994, as well as a full transcript of the proceedings before the Circuit Court on July 13, 1994, including Judge Kinnaird's oral opinion from the bench, is reprinted in full in the Appendix to this Petition. (App. 35-49.) The arbitration award issued on February 5, 1993 by the National Association of Securities Dealers, Inc. is unpublished, but a copy of the award is included in the Record on Appeal.

JURISDICTION

The Illinois Supreme Court's decision in *Roubik v. Merrill Lynch, Pierce, Fenner & Smith, Inc., et al.*, was entered on February 20, 1998. Petitioner's Petition for Rehearing was denied on March 30, 1998. Jurisdiction is conferred upon this court to review the judgment of the Illinois Supreme Court by 28 U.S.C. §1257(a) (1996).

STATUTORY PROVISIONS INVOLVED

Sections 9, 10 and 11 of the Federal Arbitration Act, 9 U.S.C. §§9, 10 and 11 (1996), are reprinted in full in the Appendix to this Petition. (App. 145-47.)

STATEMENT OF THE CASE

In 1985, Edna Roubik and her adult daughter Marcia opened a margin account with the Oak Brook, Illinois branch office of Petitioner Merrill Lynch, Pierce, Fenner &

Smith Inc. (hereinafter "Merrill Lynch"). Petitioner Thomas R. Valaika was the Resident Vice President of the office, and Petitioner Larry H. Lovitsch was the Financial Consultant assigned to the Roubik account. At the time the account was opened, Marcia and Edna Roubik signed a contract with Merrill Lynch entitled "Customer Agreement." In pertinent part, Paragraph 13 of that Agreement states as follows:

> Except to the extent that controversies involving claims arising under the Federal securities laws may be litigated, it is agreed that any controversy between us arising out of your business or this agreement shall be submitted to arbitration conducted under the provisions of the Constitution and Rules of the Board of Governors of the New York Stock Exchange, Inc. or pursuant to the Code of Arbitration Procedure of the National Association of Securities Dealers, Inc. as the undersigned may elect.

In addition, Paragraph 17 of that Agreement states as follows:

> This Agreement and its enforcement shall be governed by the laws of the State of New York . . .

In January, 1991, Respondent Marcia Roubik filed a Statement of Claim with the National Association of Securities Dealers, Inc. ("NASD") claiming misconduct by Petitioners in connection with the securities accounts opened by Respondent and her mother, who died in 1988. *Roubik v. Merrill Lynch, Pierce, Fenner & Smith Inc., et al.*, NASD Arbitration No. 91-00169. Specifically, Respondent's Statement of Claim asserted ten claims sounding in breach of contract, negligence, common law fraud and breach of fiduciary duty. Each claim prayed for an award of compensatory damages in the amount of $900,000, interest, costs, forum fees, attorneys' fees and punitive damages. Although each of the ten separate claims included a request for punitive damages, no separate

claim for punitive damages was included. On January 10, 1991, Respondent also executed a NASD Uniform Submission Agreement which provided as follows:

> The undersigned parties hereby submit the present matter in controversy, as set forth in the attached statement of claim, answers, cross claims, and all related counterclaims and/or third party claims which may be asserted, to arbitration in accordance with the Constitution, By-Laws, Rules, Regulations and/or Code of Arbitration Procedure of the sponsoring organization.

On February 19, 1991, Marcia Roubik also filed a Complaint, which mirrored the Statement of Claim, against the Petitioners before the United States District Court for the Northern District of Illinois, Eastern Division. *Roubik v. Merrill Lynch, Pierce, Fenner & Smith Inc., et al.*, Case No. 91 C 1051. On May 22, 1991, however, at the suggestion of the Hon. James Alesia, Respondent voluntarily dismissed her federal lawsuit. Although Roubik later sought to vacate her dismissal, Judge Alesia denied the request on August 7, 1991.

On November 21, 1991, the NASD arbitration panel requested that the parties brief the issue regarding the authority of the arbitrators to award punitive damages in Illinois and submit the briefs to the panel within five (5) days of the hearings. (App. 50-144.)[1] Arbitration hearings

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[1] The following briefs were submitted to the arbitrators for consideration: Claimant's Memorandum in Support of the Award of Punitive Damages by Illinois Arbitrators (App. 50-83); Respondents' Memorandum of Law on Impropriety of Punitive Damages in Arbitration Proceedings (App. 84-98); Claimant's Reply Memorandum in Support of the Award of Punitive Damages by Illinois Arbitrators (App. 99-116); Respondents' Reply Brief on the Impropriety of Punitive Damages in Arbitration Proceedings (App. 117-133); Respondents' Supplemental Memorandum Regarding Punitive Damages

were then conducted before a three-arbitrator panel at the NASD's Chicago, Illinois, regional office on various dates between October 26, 1992 and February 4, 1993.

Petitioners argued in their briefs and during oral arguments that punitive damages were unavailable in arbitration under New York law, the governing law of the proceeding pursuant to paragraph 17 of the Customer Agreement. (App. 84-98, 117-133, 134-137.) At the time, New York law prohibited punitive damages awards in arbitration proceedings. *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976). In support of the application of New York law and *Garrity*, petitioners cited, *inter alia*, the controlling state and federal cases in Illinois. *Pierson v. Dean Witter Reynolds, Inc.*, 742 F.2d 334 (7th Cir. 1984); *Edward Electric Co. v. Automation, Inc.*, 229 Ill. App. 3d 89, 593 N.E.2d 833, 838, 171 Ill. Dec. 13, 18 (1st Dist.), *appeal denied*, 146 Ill. 2d 625, 602 N.E.2d 450, 176 Ill. Dec. 796 (1992).

Respondent countered in her briefs and during oral arguments that punitive damages were available as a remedy in arbitration. (App. 50-83, 99-116, 138-144.) At no time, however, did Respondent object to the power of the arbitrators to decide the availability of punitive damages or seek a judicial determination on the question of the panel's power to decide the issue. Instead, from the outset, Respondent repeatedly asserted the arbitrators' authority to award punitive damages.

In an award issued on February 5, 1993, the NASD panel entered an award of compensatory damages in the amount of $500,000, denied Respondent's request for costs and attorneys' fees, and ordered both parties to pay one-half of the NASD forum fees. With respect to punitive damages, the arbitrators ruled as follows:

(App. 134-137); and Claimant's Reply to Respondents' Second Supplemental Memorandum Regarding Punitive Damages (App. 138-144).

> The undersigned arbitrators further find that this misconduct was such that punitive damages should be awarded. However, the panel believes that the law of New York, the forum of the parties, precludes such an award . . . Claimant, Marcia M. Roubik's claims for punitive damages and attorney's fees are hereby denied and dismissed with prejudice.

On April 30, 1993, Respondent filed her Petition to Confirm in Part and Vacate in Part the Arbitration Award with the Circuit Court of Cook County, Illinois. On October 25, 1993, Petitioners filed both their Answer to Respondent's Petition and their own Counter-Petition concerning the award, which requested that the Circuit Court confirm the award but deny Respondent's post-award interest on the ground that the delay in tender was caused by the failure of Respondent's counsel to execute the Release and Satisfaction for the arbitration award.

In her Petition before the Circuit Court, Respondent again did not question the authority of the arbitrators to decide the arbitrability of punitive damages. Instead, she pleaded that the award was unenforceable as contrary to a purported "public policy," and that the arbitrators wrongly chose New York law as controlling. In briefs before the trial court, Respondent limited herself to "public policy" arguments and assertions that Petitioners had not made a timely filing to confirm the award.

In support of their assertion that punitive damages were prohibited under New York law, Petitioners cited as authority the opinion of the United States Court of Appeals for the Seventh Circuit in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 20 F.3d 713 (7th Cir. 1994), rendered on March 30, 1994.

On July 22, 1994, the Hon. Dorothy K. Kinnaird entered her final order, (App. 36-40), upon the cross-motions for judgment, which incorporated her July 13, 1994 ruling, (App. 41-50), granting and denying each in part. Judge Kinnaird ordered the award to be confirmed

in its entirety, denied Respondent's request for partial *vacatur* of that portion of the award which denied punitive damages, and granted interest upon the award at a rate of nine percent. On that same day, Petitioners tendered $500,000 to Respondent.

On August 12, 1993, Respondent filed a Notice of Appeal to the Illinois Appellate Court. On August 22, 1993, Petitioners filed a cross-appeal contesting the Circuit Court's award of interest. The Securities Department of the Office of the Illinois Secretary of State appeared as an *amicus curiae* in support of Respondent.

On appeal to the Illinois Appellate Court, Respondent again did not attack the power of the NASD panel to decide the punitive damages issue. In her appellate brief, filed January 4, 1995, Respondent first repeated her "public policy" argument, then asserted that the Federal Arbitration Act, 9 U.S.C. §1 *et seq.*, preempted application of New York law, an argument never made before the trial court.

Although both parties requested oral argument, on May 1, 1996, the Illinois Appellate Court issued its opinion without hearing oral arguments. (App. 26-33.) In its Opinion, the Appellate Court applied a *de novo* standard of review to the arbitrators' award denying punitive damages and found this Court's March 6, 1995 opinion in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 115 S. Ct. 1212, 131 L. Ed. 2d 76 (1995), to be "controlling" on the issue of punitive damages. As a result, the Appellate Court affirmed the Circuit Court with regard to the grant of post-award interest, and reversed the Circuit Court with regard to confirmation of the denial of punitive damages. The Appellate Court remanded to the Circuit Court with directions that:

> [O]n remand, we direct the Circuit Court to enter an order compelling further NASD arbitration on the issue of punitive damages and

staying further action in the circuit court until such arbitration proceedings can be completed.

(App. 32.)

On May 22, 1996, Petitioners filed a Petition for Rehearing with the Appellate Court. In the Response to the Petition for Rehearing, Respondent asserted *for the first time* that the NASD panel had no power to consider the issue of punitive damages. In support thereof, Respondent cited this Court's opinion in *Mastrobuono*. In a unanimous Order dated October 7, 1996, the Appellate Court granted the Petitioners' Petition for Rehearing. Subsequently, in an Order dated January 3, 1997, the divided Appellate Court struck the order granting rehearing and denied the Petition for Rehearing. (App. 34.) In that Order, Justice David Cerda dissented, noting upon the face of the Order "I would grant the Petition and affirm the Circuit Court." *Id.*

Thereafter, on February 7, 1997, Petitioners sought leave to appeal to the Illinois Supreme Court solely on the issue of punitive damages. On April 2, 1997, the Supreme Court of Illinois denied the Petition for Leave to Appeal. On April 23, 1997, Petitioners filed a motion requesting the Illinois Supreme Court to reconsider its order denying the Petition for Leave to Appeal, which was granted by the Illinois Supreme Court on May 13, 1997. After submission of briefs and oral arguments, on February 20, 1998, the Illinois Supreme Court rendered its Opinion, affirming the Illinois Appellate Court in all respects. (App. 1-24.) On March 13, 1998, Petitioners filed a Petition for Rehearing which was denied by the Illinois Supreme Court on March 30, 1998. (App. 25.)

REASONS FOR GRANTING THE PETITION

The Supreme Court of Illinois has deeply undermined alternative dispute resolution in this country through an unprecedented intrusion of the judiciary into the arbitral process. The *Roubik* court applied this Court's opinions in *First Options of Chicago, Inc. v. Kaplan*, 514 U.S.

938, 115 S. Ct. 1920, 131 L. Ed. 2d 985 (1995), and *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 115 S. Ct. 1212, 131 L. Ed. 2d 76 (1995), to vacate an arbitration panel's denial of punitive damages in an award entered two years before *Mastrobuono*, even though the arbitration panel followed the controlling law at the time.

The questions presented by this case are of great importance to the realization of a national policy with respect to arbitration. The Supreme Court of Illinois has created a national conflict on a key issue remaining after *First Options*, namely, the line of demarcation between the power of a court to determine the arbitrability of the merits of a dispute, and the power of an arbitrator to determine "merits-related" issues which are specifically submitted to the arbitrator for decision. In the view of the Illinois Supreme Court, *First Options* has created a legal framework in which, absent clear and unmistakable evidence of the parties' agreement to the contrary, judicial power extends far beyond the "threshold" issue of the arbitrability of the merits of a dispute, and allows *de novo* judicial review of non-merits issues, such as the availability of a remedy, which have no impact upon the access to an arbitral forum.

It is the position of Petitioners, as well as at least five federal Courts of Appeals, that, absent clear and unmistakable evidence of the parties' agreements to the contrary, *First Options* limits the judicial role to "threshold" questions of whether the parties executed a valid agreement to arbitrate and whether the merits of the dispute are within the scope of the agreement. If the merits of the dispute are subject to arbitration under the parties' arbitration agreement, then merits-related issues, such as the availability of punitive damages, are assigned to the arbitrators.

A second conflict is created by the fact that the Illinois Supreme Court decided that Petitioners presented no "clear and unmistakable" evidence that the parties intended an arbitral resolution of the punitive damages

question. In reaching such a decision, the *Roubik* court chose to review the terms of the parties' agreement to arbitrate without examining the parties' conduct in carrying out the arbitration process. The Illinois Supreme Court has taken a position sharply different from this Court's analysis in *First Options*, in which the actual conduct of the parties at the hearing was carefully considered, as well as that of the federal Courts of Appeals, which hold that a claimant may not voluntarily submit an issue to arbitration, await the outcome, and, if the decision is unfavorable, then challenge the authority of the arbitrator to act. The analysis employed by this Court and the Courts of Appeals is not only a more just approach, but a view which upholds the finality and integrity of the arbitral process.

A third fundamental issue arising in the case at bar is whether the courts of Illinois have the power to compel further arbitration by the arbitrators to issue punitive damages. The arbitration was conducted before a private national securities association arbitration panel which concluded its service after it rendered the award some five years earlier. Additionally, the court let stand the $500,000 compensatory damages award, and thus vacated only part of the award. Further hearings by the *Roubik* arbitration panel would violate the doctrine of *functus officio*, which bars such a result.

The *Roubik* decision has national impact on arbitration. Illinois is a key state for the nation's capital markets and futures industries, which have fully embraced alternative dispute resolution. The NASD maintains one of its four regional offices in Chicago, with the others being in New York, San Francisco and Fort Lauderdale, Florida. Not only does the NASD office in Chicago handle all the cases arising from the bustling financial activity in Chicago, but arbitration proceedings from throughout the Midwest are frequently brought to Chicago for final hearing. Even beyond the NASD regional office, Chicago is home to the Chicago Board of Trade, the Chicago Board

Options Exchange, the Chicago Mercantile Exchange, the Chicago Stock Exchange, and an extensive number of home or branch offices for members of the capital markets and commodities industries. Thus, Illinois case law in the area of arbitration is of no small importance nationwide, and the impact of the decisions of the Illinois courts can be far reaching. Accordingly, the *Roubik* appeal has been carefully watched by the legal practitioners and industries who regularly deal with arbitration.

In sum, the Supreme Court of Illinois held that any arbitral interpretation of an arbitrator's powers is subject to *de novo* review by the courts even when the parties affirmatively submitted the issue for arbitral decision; changes in law occurring years after the arbitrators' good-faith decision may be used to vacate the award; and closed private arbitrations may be reopened years later to compel arbitrators to fashion a punitive damages award in keeping with a court's view of the case. In *Volt Information Services, Inc. v. Bd. of Trustees*, 418 U.S. 468, 476, 109 S. Ct. 1248, 1254, 103 L. Ed. 2d 488 (1989), this Court held that "[t]here is no federal policy favoring arbitration under a certain set of rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate." The Illinois Supreme Court's opinion in *Roubik* both undermines that policy and dangerously threatens the continued viability of alternative dispute resolution as a meaningful, effective and efficient alternative to the judicial process. A Writ of *Certiorari* is respectfully requested.

I. THE NASD ARBITRATION PANEL WAS THE PROPER TRIBUNAL TO DECIDE THE "MERITS-RELATED" ISSUE OF THE AVAILABILITY OF PUNITIVE DAMAGES IN THE PARTIES' ARBITRATION.

In a stunning decision which conflicts with the holdings and language of several decisions of this Court and at least five opinions from the federal Courts of Appeals,

the Supreme Court of Illinois has extended *de novo* review to an arbitration panel's decision on remedy in an arbitrable dispute. The *Roubik* court has challenged the holdings of no less than three decisions of this Court which call for an arbitral rather than judicial decision on such questions. *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 84 S. Ct. 909, 11 L. Ed. 2d 898 (1964); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 396, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967); and *Paperworkers Union v. Misco, Inc.*, 484 U.S. 29, 108 S. Ct. 364, 98 L. Ed. 2d 286 (1987). In *John Wiley* this Court stated:

> Once it is determined . . . that the parties are obligated to submit the subject matter of a dispute to arbitration, "procedural" questions which grow out of the dispute and bear on its final disposition should be left to the arbitrator.

John Wiley, 376 U.S. at 557, 84 S. Ct. at 918. The statement of this Court in *Misco* was even more direct:

> Because the parties have contracted to have disputes settled by an arbitrator chosen by them rather than by a judge, it is the arbitrator's view of the facts and of the meaning of the contract that they have agreed to accept. *Courts thus do not sit to hear claims of factual or legal error by an arbitrator as an appellate court does in reviewing decisions of lower courts* . . . So, too, where it is contemplated that the arbitrator will determine remedies for contract violations that he finds, courts have no authority to disagree with his honest judgment in that respect. If the courts were free to intervene on these grounds, the speedy resolution of grievances by private mechanisms would be *greatly* undermined.

484 U.S. 29, 108 S. Ct. 364, 370, 98 L. Ed. 2d 286 (1987) (emphasis added). As stated by Chief Judge Posner of the Seventh Circuit:

> As we have said too many times to want to repeat again, the question for decision by a federal court asked to set aside an arbitration award . . . is not whether the arbitrator or arbitrators erred in interpreting the contract; it is not whether they clearly erred in interpreting the contract; it is not whether they grossly erred in interpreting the contract; it is whether they interpreted the contract. [citations omitted]. If they did, their interpretation is conclusive.

Hill v. Norfolk & W. Ry. Co., 814 F.2d 1192, 1195 (7th Cir. 1987).

The Illinois Supreme Court has taken a completely contrary view, holding instead that, notwithstanding the parties' execution of a broad arbitration clause, any decision which can conceivably be construed as "defining the jurisdiction of the arbitrator" is for the courts, not the arbitrator to decide. Such a formulation not only deprives parties of their contractual right to arbitrate, but promotes a means by which disappointed arbitral litigants can pursue *vacatur* in the courts. Worse still, it means that the arbitration award will be the commencement of the litigation, not the final award for which the parties bargained.

A. The Supreme Court Of Illinois Is In Conflict With Federal And State Cases Which Interpret *First Options* To Narrow The Judicial Role To "Threshold" Decisions On The Merits Of A Dispute, With "Merits-Related" Decisions Such As Affirmative Defenses And Remedies Being For The Arbitrators To Decide.

By extending *de novo* judicial review to the arbitrators' decision on remedies in a fully arbitrable dispute, the Supreme Court of Illinois has created a national split of authority in applying this Court's decision in *First Options*, wherein this Court delineated the respective

powers of courts and arbitrators in determining the arbitrability of disputes. Justice Breyer's key description was as follows:

> This Court, however, has (as we just said) added an important qualification, applicable when courts decide whether a party has agreed that arbitrators should decide arbitrability: Courts should not assume that the parties agreed to arbitrate arbitrability unless there is "clea(r) and unmistakable" evidence that they did. *AT&T Technologies, supra,* at 649, 106 S. Ct. at 1418-1419; *see Warrior & Gulf, supra,* at 583, n.7, 80 S. Ct., at 1353, n.7. In this manner the law treats silence or ambiguity about the question "who (primarily) should decide arbitrability" differently from the way it treats silence or ambiguity about the question "whether a particular merits related dispute is arbitrable because it is within the scope of a valid arbitration agreement" – for in respect to this latter question the law reverses the presumption. *See Mitsubishi Motors, supra,* at 626, 105 S. Ct., at 3353 (" '(A)ny doubts concerning the scope of the arbitrable issues should be resolved in favor of arbitration' ") (*quoting Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25, 103 S. Ct. 927, 941, 74 L. Ed. 2d 765 (1983); *Warrior & Gulf, supra,* at 582-583, 80 S. Ct., at 1352-1353.
>
> But, this difference in treatment is understandable. The latter question arises when the parties have a contract that provides for arbitration of some issues. In such circumstances, the parties likely gave at least some thought to the scope of arbitration. And, given the law's permissive policies in respect to arbitration, *see e.g., Mitsubishi Motors, supra,* at 626, 105 S. Ct., at 3353, one can

> understand why the law would insist upon clarity before concluding that the parties did not want to arbitrate a related matter. *See* Domke §12.02, p. 156 (issues will be deemed arbitrable unless "it is clear that the arbitration clause has not included" them). On the other hand, the former question – the "who (primarily) should decide arbitrability" question – is rather arcane. A party often might not focus upon that question or upon the significance of having arbitrators decide the scope of their powers. Cf. Cox, Reflections Upon Labor Arbitration, 72 *Harv.L.Rev.* 1482, 1508-1509 (1959), cited in *Warrior & Gulf*, 363 U.S., at 583, n.7, 80 S. Ct., at 1353, n.7. And, given the principle that a party can be forced to arbitrate only those issues it specifically has agreed to submit to arbitration, one can understand why courts might hesitate to interpret silence or ambiguity on the "who should decide arbitrability" point as given the arbitrators that power, for doing so might too often force unwilling parties to arbitrate a matter they reasonably would have thought a judge, not an arbitrator, would decide. *Ibid. See generally, Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 219-220, 105 S. Ct. 1238, 1241-1242, 84 L. Ed. 2d 158 (1985) (Arbitration Act's basic purpose is to "ensure judicial enforcement of privately made agreements to arbitrate").

513 U.S. at 944-45, 115 S. Ct. at 1924-25.

The sharp and prominent disagreement between several federal Courts of Appeals and the Supreme Court of Illinois can be viewed as disputing the definition of "arbitrability" and a "merits-related dispute." Decisions of at least five federal Courts of Appeals have interpreted *First Options* to hold that, unless the parties clearly and unmistakably demonstrate otherwise, courts should decide the threshold issue of the availability of an arbitral process

for the merits of a dispute, and leave to the arbitrators to resolve "merits-related" issues arising from interpretation and application of the contract, including matters which may affect the arbitral outcome, such as affirmative defenses and remedies. *MCI Telecommunications Corp v. Matrix Communications Corp.*, 35 F.3d 27 (1st Cir.), *petition for cert. filed, 66 USLW 3733 (Apr. 27, 1998); Nat. Union Fire Ins. Co. v. Belco Petroleum Corp.*, 88 F.3d 129 (2d Cir. 1996); *Great Western Mortgage Corp. v. Peacock*, 110 F.3d 222 (3d Cir.), *cert. denied*, ___ U.S. ___, 118 S. Ct. 299, 139 L. Ed. 2d 230 (1997); *Glass v. Kidder Peabody & Co.*, 114 F.3d 446, 453 (4th Cir. 1997); *Flexible Mfg. Systems PTY, Ltd. v. Super Products, Ltd.*, 86 F.3d 96 (7th Cir. 1996).

In *Nat. Union Fire Ins. Co. v. Belco Petroleum Corp.*, the case arose from insurance claims made by Belco after the Peruvian government seized Belco's operations in that country. When Belco's insurers denied its claims, the matter was decided by arbitration in Belco's favor. Later, Belco made additional claims against different insurers for maritime losses created by Peruvian seizures, which were paid. The first insurers then claimed that their policies allowed them to recoup monies from the maritime insurance proceeds received by Belco, and commenced a second arbitration. Belco then filed a court action to halt the arbitration on ground that the first arbitration award barred a new proceeding under *res judicata*. The District court ruled that the new arbitrators should decide the *res judicata* issue. 88 F.3d at 132.

Citing *First Options*, the Court of Appeals for the Second Circuit affirmed the District Court's decision:

> The arbitrability issue in *First Options* was whether certain individuals were bound by an arbitration agreement that they did not sign. ___ U.S. at ___-___, 115 S. Ct. at 1922-1923. The question – is there a valid arbitration agreement between the parties at all – is, under the FAA, a question for the court to decide unless the parties have unmistakably assigned that task to the

> arbitrator. *Id.* at ___, 115 S. Ct. at 1924. But "when the parties have a contract that provides for arbitration of some issues," the question becomes "whether a particular merit-related dispute is arbitrable because it is within the scope of a valid arbitration agreement." *Id.* (quotation omitted). In that context, "the law reverses the presumption" and any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration." *Id.*

Id. at 135. The Seventh Circuit's interpretation is parallel:

> In *First Options,* the Court concluded that the question "who should have the primary power to decide" whether a dispute is arbitrable or not depends upon what the parties agreed to arbitrate. In the case before it, nothing indicated that parties had clearly agreed to have the arbitrators decide the arbitrability issue, and thus the Court concluded that the question was for the district court. In passing, the Court distinguished its case from one in which the parties have a contract that provides for arbitration of some issues, and the issue is the scope of the agreement. In the latter circumstance, the rule requiring any doubts concerning the scope of arbitration to be resolved in favor of arbitration comes into play.

Flexible Mfg. Systems PTY, Ltd. v. Super Products, Ltd., 86 F.3d 96, 99 (7th Cir. 1996).

The Third Circuit's decision in *Peacock* only more starkly demonstrates the schism now created by the decision in *Roubik.* In *Peacock,* a female employee brought a state court action claiming sexual harassment in violation of New Jersey's Law Against Discrimination ("NJLAD"). The employer filed a federal action to compel arbitration under the FAA, citing arbitration agreements signed by the employee when she commenced her employment

which barred the arbitrator from awarding punitive damages. Arbitration was ordered, and the employee appealed. In resisting arbitration, the employee argued that the waiver of punitive damages contained in her arbitration agreement was void as against public policies against harassment expressed by passage of the NJLAD. The Third Circuit ruled that the availability of punitive damages under the agreement was for the arbitrator to decide:

> Once a dispute is determined to be validly arbitrable, all other issues are to be decided at arbitration. Since the purpose of the FAA is to ensure that agreements to arbitrate are enforced, a court compelling arbitration should preserve the remaining disputed issues for the arbitrator to decide. Any argument that the provisions of the Arbitration Agreement involve a waiver of state substantive rights afforded by the state statute may be presented in the arbitral forum. It would be anomalous for a court to decide that a claim should be referred to an arbitrator rather than a court, and then, by deciding issues unrelated to the question of forum, foreclose the arbitrator from deciding them.

110 F.3d at 230-231. Importantly, the Court of Appeals ruled that the arbitrator, and not the court, was to decide if the arbitration agreement constituted an enforceable waiver of punitive damages:

> We also do not rule on whether Peacock has waived her right to punitive damages under NJLAD – a waivable state right not preempted by the FAA. The availability of punitive damages is not relevant to the nature of the forum in which the complaint will be heard. Thus, availability of punitive damages cannot enter into a decision to compel arbitration. NJLAD provides that a victim of unlawful discrimination may be awarded punitive damages, but the issue of

> whether this right had been waived, *see Swarts v. Sherwin-Williams Co.*, 244 N.J. Super 170, 581 A.2d 1331 (App. Div. 1990), is separate and apart from the issue of whether an employee has agreed to an arbitral forum, and hence, is for the arbitrator to decide. *See Mastrobuono*, 514 U.S. 52, 115 S. Ct. 1212, 131 L. Ed. 2d 76 (1995).

Id. at 232. The holding in *Peacock* has been cited with approval by the First Circuit in *MCI Telecommunications Corp. v. Matrix Communications Corp.*, 135 F.3d 27, 33, n.12 (1st Cir. 1998).

Just as in *Roubik*, in *Peacock* the merits of the dispute were fully arbitrable, but the parties debated the effect of a clause in the arbitration agreement which barred punitive damages as a remedy in arbitration. Both the *Peacock* and *Roubik* courts relied upon *First Options* as controlling authority. The Third Circuit held that the effect of the clause was for the arbitrators to decide, while the Supreme Court of Illinois held that "this issue addresses the scope of the arbitrators' authority, and is therefore a matter independently reviewable by the courts." 181 Ill. 2d at 389, 692 N.E.2d at 1174, 230 Ill. Dec. at 8.

Simply put, if it is anomalous for the court to resolve the issue prior to arbitration, it is even more odd for the court to decide the same issue after entry of an award, especially in the circumstances of the case at bar, in which Claimant voluntarily requested that the arbitrators make the decision.

The contradictory nature of the Illinois Supreme Court's decision is amplified by its contradictory treatment of case law. In the opinion the Court distinguished a series of cases in which courts considered whether the parties' adoption of the NASD Code of Arbitration procedure meant that Section 35 of the Code gave the arbitrators the power to interpret and apply the Code and the power to rule on whether claims were ineligible for arbitration under Section 15, which imposed a six year window of eligibility for the submission of claims. In the

same opinion, however, the court rejected the distinction made in *Peacock, Belco, Glass,* and *Flexible Mfg. Systems* by citing *Cogswell v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 78 F.3d 474 (10th Cir. 1996), *Edward D. Jones & Co. v. Sorrells*, 957 F.2d 509 (7th Cir. 1992), and *Smith Barney, Inc. v. Schell*, 53 F.3d 807 (7th Cir. 1995), each of the latter being a section 35 case, and thus previously distinguished.

The *Roubik* court has improperly extended *de novo* review from the "threshold" question of whether a valid arbitration agreement encompasses the merits of a dispute to arbitrators' deliberations on a remedy issue which was voluntarily submitted by the parties for an arbitral decision. Under such a rule of law, any disappointed arbitral litigant can pursue *de novo* judicial review to vacate an award if a decision can in any way be portrayed as addressing "the scope of the arbitrators' authority." The *Roubik* analysis is therefore but a short step from full judicial review of arbitration awards, a legal framework decried by this Court for over 140 years:

> Arbitrators are judges chosen by the parties to decide the matters submitted to them, finally and without appeal. As a mode of settling disputes, it should receive every encouragement from courts of equity. If the award is within the submission, and contains the honest decision of the arbitrators, after a full and fair hearing of the parties, a court of equity will not set it aside for error either in law or fact. A contrary course would be a substitution of the judgment of the chancellor in place of the judges chosen by the parties, and would make an award the commencement, not the end, of litigation.

Burchell v. Marsh, 58 U.S. (17 How.) 344, 349, 15 L.Ed. 96, 99 (1855).

B. The Supreme Court Of Illinois Applied An Incorrect And Over-Expansive Definition Of "Arbitrability" In Applying De Novo Review To A Non-Merits Issue.

This Honorable Court is urged to grant a Writ of *Certiorari* to resolve an issue not addressed in *First Options:* the definition of a "dispute" for purposes of arbitrability. A central error made by the *Roubik* court was to treat the parties' dispute over the availability of a remedy as separable from the merits of the Roubik's claims for purposes of analysis under *First Options:*

> We agree with the claimant that the issue of whether the arbitrators had the authority to award punitive damages in this case was a question of arbitrability and, as such, is subject to *de novo* review.
>
> * * *
>
> This issue addresses the scope of the arbitrators authority and is therefore a matter independently reviewable by the courts.

Roubik, 181 Ill. 2d at 383-89, 692 N.E.2d at 1172-74. In reaching this key definition, the *Roubik* court specifically relied upon this Court's opinion in *Mastrobuono,* in which Justice Stevens referred to the issue as one of "arbitrability." *Mastrobuono,* 514 U.S. at 58, 115 S. Ct. at 1216. The Supreme Court of Illinois simply ignored Justice Stevens' disclaimer in *Mastrobuono,* that the opinion was not attempting to define a proper standard of review. 514 U.S. at 54, n.1, 115 S. Ct. at 1214, n.1. Moreover, members of this Court have noted that the term "arbitrability" has been used in more than one context. Transcript of Oral Argument, *First Options of Chicago, Inc. v. Kaplan,* Case No. 94-560, 1995 WL 242250, pp. 29-30.

While the opinion in *First Options* reaffirmed that arbitrability of a claim is for courts to decide unless the parties clearly and unmistakably agree otherwise, nowhere in the opinion was it asserted that the judicial

role should extend to determining every conceivable issue of arbitrability, even after it is determined that the merits of the dispute are arbitrable. In fact, the *First Options* opinion states that once a court has determined that the parties agreed to an arbitral forum to resolve the merits of their claim, federal law imposes a presumption that "merits-related disputes" are "arbitrable," *i.e.*, to be resolved and decided by the arbitration panel. 115 S. Ct. at 1924.

This conclusion is buttressed by prior decisions of this Court. In *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 396, 87 S. Ct. 1801, 18 L. Ed. 2d 1270 (1967), this Court ruled that a defense of fraud in the inducement to enter a contract was arbitrable, even though the contract in question contained the arbitration agreement. In that case, it was not contested that the merits of the dispute, which were the services provided and amounts due under a consulting agreement, were covered by the broad arbitration clause of the parties' contract. Noting the existence of a broad arbitration clause, this Court held that issues affecting the outcome of an arbitrable dispute were for the arbitrators to resolve:

> In the present case no claim has been advanced by Prima Paint that F & C fraudulently induced it to enter into the agreement to arbitrate "[a]ny controversy or claim arising out of or relating to this Agreement, or the breach thereof." This contractual language is easily broad enough to encompass Prima Paint's claim that both the execution and acceleration of the consulting agreement itself were procured by fraud. Indeed, no claim is made that Prima Paint ever intended that "legal" issues relating to the contract be excluded from arbitration, or that it was not entirely free to so contract.

Prima Paint, 388 U.S. at 405, 87 S. Ct. at 1807.

The availability of punitive damages under the Roubik Customer Agreement is precisely the type of "merits-related" issue described in *First Opinions*, and the "legal" issue relating to the contract described in *Prima Paint*. The issue does not affect access to the arbitration process, because the merits of the dispute, Roubik's claims of fraud and other misconduct, are fully arbitrable. The issue is not independent of the merits, because the panel's consideration of the issue is necessarily contingent upon the panel's resolution of the merits in favor of Roubik. Respondent made no effort to submit a separate distinct claim for punitive damages and Illinois does not recognize a cause of action for punitive damages alone. *Kemner v. Monsanto*, 217 Ill. App. 3d 188, 189, 576 N.E.2d 1146, 1153, 160 Ill. Dec. 192 (5th Dist.), *appeal denied*, 142 Ill. 2d 655, 584 N.E.2d 130, 164 Ill. Dec. 918 (1991).

The *Roubik* court's act of equating the remedies with merits forced the Illinois Supreme Court to the odd act of reviewing the arbitration clause of the parties' Customer Agreement for a reference to punitive damages. The startling implication of the *Roubik* court's analysis is that, at the time the agreement to arbitrate is formed, the parties must foresee all possible merits-related issues arising from future arbitration, and include "clear and unmistakable" language in the arbitration agreement to guarantee an arbitral ruling on the side issues, upon pain of *de novo* review by the courts and possible *vacatur* of an award. Not only is such a rule unworkable, but its adoption would so undermine the arbitration process as to bring into doubt its continued existence as an efficient and effective alternative dispute resolution process. Petitioners would instead suggest that, subject to the safeguards set forth in the FAA and federal common law, the decision rendered by the parties' chosen arbitration forum on both the merits and the merits-related disputes must be honored.

C. The Supreme Court Of Illinois Erroneously Adopted *De Novo* Judicial Review Of An Arbitrator's Interpretation Of Remedies Under The Parties' Arbitration Clause.

Section 10(a)(4) of the FAA authorizes *vacatur* when the arbitrators exceed the powers granted under the arbitration agreement. 9 U.S.C. §10 (1996). The Illinois Supreme Court has now created a non-statutory ground for *vacatur* which is a hazy reflection of Section 10(a): that the arbitrators failed to act to the very limit of their powers as interpreted by a court. Not only is such a standard completely subjective, but it is in direct contravention of federal law which allows arbitrators to interpret contracts. The parties to an arbitration bargain for decisions of the chosen forum, not that of the courts. No award is safe from judicial interference under the standard created by the Illinois Supreme Court.

II. THE PARTIES' CONDUCT DEMONSTRATED A "CLEAR AND UNMISTAKABLE" INTENT THAT THE ARBITRATION PANEL DECIDE THE AVAILABILITY OF PUNITIVE DAMAGES.

In the case at bar, the Illinois Supreme Court justified *de novo* review on the strained rationale that the parties never agreed to submit the issue of the availability of punitive damages to the arbitrators, thereby both placing the arbitrability question within the judicial sphere of power and precluding any deference to the arbitrators' decision. Directly contrary to the suggestion made by Justice Bilandic that Petitioners "do not contend that the parties in this case agreed to allow arbitrators to decide questions of arbitrability," Petitioners fully raised the conduct of Respondent in their briefs before the court. Petitioners argued as follows:

> In the arbitration proceeding, Claimant actively sought the arbitrators' ruling on punitive damages, and never objected to the power of the

> arbitrators to decide the issue . . . Claimant openly and intentionally placed the decision before the arbitrators, and cannot now be heard to attack the panel's power to rule on the matter.

The *Roubik* court, however, limited its search for "clear and unmistakable evidence" that the parties chose to obtain an arbitral decision on arbitrability to the four corners of the parties' written agreement. The *Roubik* court blindly ignored Respondent's pursuit of punitive damages before the arbitration panel. The court's failure to examine "conduct" is not only in conflict with *First Options*, in which the conduct of Manuel Kaplan was fully reviewed, but also a large and unified body of cases from the federal Courts of Appeals which hold that a party cannot pursue a decision in arbitration, then, having received an adverse decision, attack the panel's power to decide the issue. *DiRussa v. Dean Witter Reynolds, Inc.*, 121 F.3d 818 (2d Cir. 1997), *cert. denied*, ___ U.S. ___, 118 S. Ct. 695, 139 L. Ed. 2d 639, *reh'g denied*, ___ U.S. ___, 118 S. Ct. 1180, 140 L. Ed. 2d 187 (1998); *Jones Dairy Farm v. United Foods and Commercial Workers Union*, 760 F.2d 173 (7th Cir.), *cert. denied*, 474 U.S. 845, 106 S. Ct. 136, 88 L. Ed. 2d 112 (1985); *John Morell & Co. v. United Food and Commercial Workers*, 913 F.2d 544, 561 (8th Cir. 1990), *cert. denied*, 500 U.S. 905, 111 S. Ct. 1683, 114 L. Ed. 2d 78 (1991); *Local 238 International Bhd. of Teamsters v. Cargill, Inc.*, 66 F.3d 988, 990-991 (8th Cir. 1995); *George Day Construction Co. v. United Bhd. of Carpenters and Joiners of Am.*, 722 F.2d 1471 (9th Cir. 1984); *Fortune, Alsweet Eldridge, Inc. v. Daniel*, 724 F.2d 1355 (9th Cir. 1983).

In *First Options*, this Court established guidelines:

> When deciding whether the parties agreed to arbitrate a certain matter (including arbitrability), courts generally (although with a qualification we discuss below,) should apply ordinary state-law principles that govern the formation of contracts.

First Options, 514 U.S. at 944, 115 S. Ct. at 1924. In *Dept. of Revenue v. Jennison-Wright Corp.*, 393 Ill. 401, 408, 66 N.E.2d 395, 399 (1946), the Illinois Supreme Court ruled:

> [t]he construction of a contract is to ascertain the intention of the parties, and there is no more convincing evidence of what the parties intended than to see what they did in carrying out its provisions.

See also, Mitchell v. Ill. Cent. R. Co., 384 Ill. 258, 51 N.E.2d 271 (1943); *Estate of Jesmer v. Rohlev*, 241 Ill. App. 3d 798, 609 N.E.2d 816, 182 Ill. Dec. 282 (1993). New York law is in accord. *Madawick Contracting Co. v. Travelers Ins. Co.*, 307 N.Y. 111, 120 N.E.2d 520 (1954); *Atwater v. Panama R. Co.*, 255 N.Y. 496, 175 N.E. 189 (1931).

In the case at bar, Respondent actively sought the arbitrators' ruling on punitive damages, and never objected to the power of the arbitrators to decide the issue. Importantly, in her Statement of Claim filed before the NASD, Respondent requested punitive damages twelve times in her ten separate counts. Respondent also submitted memoranda which asserted the power of the panel to award punitive damages, while Petitioners asserted that application of New York law precluded such an award. (App. 50-144.) Respondent openly and intentionally placed the decision before the arbitrators, and cannot now be heard to attack the panel's power to rule on the matter.

In her original petition before the Circuit Court of Cook County, Respondent did not attack the power of the arbitrators to decide on the availability of punitive damages. Instead, she pleaded that the award was unenforceable as contrary to a purported "public policy," and that the arbitrators wrongly chose New York law as controlling. Later, Respondent again limited herself to "public policy" arguments and assertions that Petitioners had not made a timely filing to confirm the award.

This Court is asked to hold that Repondent's conduct in voluntarily submitting the question of the availability

of punitive damages to the arbitration panel for decision constituted "clear and unmistakable evidence" of the parties' intent to arbitrate the issue, thereby mandating a deferential standard of judicial review.

III. THE SUPREME COURT OF ILLINOIS ERRED BY APPLYING A CHANGE IN CONTROLLING LAW TO VACATE A PRIVATE ARBITRATION AWARD WHICH WAS ISSUED BEFORE THE CHANGE IN LAW OCCURRED.

The *Roubik* case sets the disturbing precedent of *vacatur* of an arbitration award by a change in law which occurred some two years after the arbitrators made their good faith finding on applicable law. This Court is asked to hold that *vacatur* was not proper simply because a widely debated issue of law was finally resolved by this Court.

While no provision of the FAA permits *vacatur* simply because the arbitrators erred in law, this Court has recognized a test of "manifest disregard of the law." *First Options*, 514 U.S. at 942, 115 S. Ct. at 1923. Under such a test, the arbitrators must be aware of controlling law and simply refuse to follow it. *Montes v. Shearson Lehman Bros., Inc.*, 128 F.3d 1456, 1461 (11th Cir. 1997). In the case at bar, the panel's finding that New York law controlled the punitive damages issue was in agreement with the controlling federal precedent of the time. *Pierson v. Dean Witter Reynolds, Inc.*, 742 F.2d 334 (7th Cir. 1984). The Illinois Appellate Court for the First District had recently adopted *Garrity. Edward Electric Co. v. Automation, Inc.*, 229 Ill. App. 3d 89, 593 N.E.2d 833, 838, 171 Ill. Dec. 13, 18 (1st Dist.), *appeal denied*, 146 Ill. 2d 625, 602 N.E.2d 450, 176 Ill. Dec. 796 (1992). Thus, for an arbitration panel sitting in Chicago as of February, 1993, controlling state and federal law dictated that punitive damages were barred. This Court's opinion in *Mastrobuono* was but one more, albeit conclusive, opinion on a widely disputed issue of contract interpretation.

Moreover, sharp procedural differences distinguish *Mastrobuono* from *Roubik*. In *Mastrobuono*, the arbitration panel awarded punitive damages, but the district court vacated the award on ground that the arbitrators exceeded their powers, which is a valid ground for *vacatur* under the FAA. 9 U.S.C. §10(a)(4) (1996). In *Roubik* there is no claim that the panel exceeded its powers. Unlike in *Mastrobuono*, in the case at bar the arbitrators *withheld* from awarding punitive damages, and this Court is presented with a *confirmed* arbitration award. Rather, if anything, *Mastrobuono* preserved the province of the arbitrators by upholding their award, including their interpretation of the parties' contract. Similarly, in the case at bar, an arbitral decision was bargained for between the parties and should stand.

Moreover, in applying *Mastrobuono* to vacate an entered award, the Illinois Supreme Court simply ignored this Court's admonitions to limit the role of judicial review:

> It is the arbitrator's construction which was bargained for; and so far as the arbitrator's decision concerns construction of the contract, the courts have no business overruling him because their interpretation of the contract is different from his.

United Steelworkers of America v. Enterprise Wheel & Car Corp., 363 U.S. 593, 599, 80 S. Ct. 1358, 1362, 4 L. Ed. 2d 1424, 1429 (1960).

The Illinois Supreme Court's reasoning is little more than a "thinly veiled attempt to obtain appellate review of an arbitrator's decision," a practice decried by federal courts. *Widell v. Wolf*, 43 F.3d 1150, 1151 (7th Cir. 1994). The decision represents a substantial departure from this Court's precedents in a growing and important field of law, and is worthy of this Court's review.

IV. AS A MATTER OF FEDERAL LAW UNDER THE ARBITRATION ACT, THE ILLINOIS COURTS CANNOT MANDATE FURTHER ARBITRATION HEARINGS ON THE ISSUE OF PUNITIVE DAMAGES.

The mandate of the Illinois courts that Petitioners be compelled to engage in "further NASD arbitration on the issue of punitive damages" is without legal authorization, because federal law precludes remand to an arbitration panel for further proceedings on the merits. The FAA does not authorize courts to mandate "further arbitration hearings" on the merits. *See* 9 U.S.C. §§9, 10, 11. The applicable law was reviewed by the Court of Appeals for the Third Circuit in *Colonial Penn Ins. Co. v. Omaha Indem. Co.*, 943 F.2d 327, 331-2 (3d Cir. 1991):

> As a general rule, once an arbitration panel renders a decision regarding the issues submitted, it becomes *functus officio* and lacks any power to reexamine that decision. [citations omitted.] Despite certain distinctions between common law and statutory arbitrations . . . the *functus officio* doctrine has been routinely applied in federal cases brought pursuant to the Federal Arbitration Act. [citations omitted.]
>
> The policy underlying this general rule is an "unwillingness to permit one who is not a judicial officer and who acts informally and sporadically, to re-examine a final decision which he has already rendered, because of the potential evil of outside communication and unilateral influence which might affect a new conclusion. [citations omitted.] Further, notwithstanding the fact that an increased utilization of arbitration in recent years has to some extent created the office of the specialized professional arbitrator, the continuity of judicial office and the tradition which surrounds judicial conduct is lacking in

> the isolated activity of an arbitrator. [citation omitted.]

Prior to the case at bar, the federal and state courts were in accord: the common law doctrine of *functus officio* precludes arbitrators from exercising jurisdiction over a case once a final award has been rendered. *See, e.g., Teamsters Local 312 v. [illegible]ack, Inc.*, 118 F.3d 985 (3d Cir. 1997); *Anderson v. Norfolk & Western Ry.*, 773 F.2d 880 (7th Cir. 1985); *Domino Group, Inc. v. Charlie Parker Memorial Foundation*, 985 F.2d 417, 420 (8th Cir. 1993); *Mercury Oil Refining Co. v. Oil Workers Int'l Union, CIO*, 187 F.3d 980, 983 (10th Cir. 1951); *Waterfront Marine Construction, Inc. v. North End 49ers Sandbridge Bulkhead Groups*, 251 Va. 417, 429, 468 S.E.2d 894, 901 (1996).

The *Colonial Penn* court also noted that while a court may resubmit an award to a panel to correct a mistake on the face of an award, that exception is very narrow, and is limited to "clerical mistakes or obvious errors in arithmetic computation." 943 F.2d at 333. The only other allowed grounds for remand are if the arbitrators failed to address all issues submitted to them or if the award is ambiguous to the degree that the court is unable to state what relief is to be confirmed and requires clarification from the arbitration panel. *NCR Corp. v. SAC-CO, Inc.*, 43 F.3d 1076 (6th Cir.), *cert. denied sub nom, SAC-CO, Inc. v. AT&T Global Informations Sys. Co.*, 516 U.S. 906, 116 S. Ct. 272, 133 L. Ed. 2d (1995).

Applying these principles, the arbitration panel which heard the case and entered the arbitration award of February, 1993 is now *functus officio*, and incompetent to revisit the merits of the award.

CONCLUSION

Petitioner, MERRILL LYNCH, PIERCE, FENNER & SMITH INC., LARRY H. LOVITSCH and THOMAS R. VALAIKA, hereby request that this Honorable Court grant a Writ of Certiorari to the Supreme Court of Illinois upon the issues raised herein.

Respectfully submitted,

Merrill Lynch, Pierce, Fenner & Smith Inc., Larry H. Lovitsch and Thomas R. Valaika

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Illinois Supreme Court

(No. 82752 – Appellate court judgment affirmed.)

MARCIA M. ROUBIK, Appellee, v.
MERRILL LYNCH, PIERCE, FENNER &
SMITH, INC., *et al.*, Appellants.

Opinion filed February 20, 1998. –
Rehearing denied March 30, 1998.

Appeal from the Appellate Court for the First District; heard in that court on appeal from the Circuit Court of Cook County, the Hon. Dorothy K. Kinnaird, Judge, presiding.

Cantwell & Cantwell, of Chicago (Peter A. Cantwell and Stephen F. Boulton, of counsel), for appellants.

Fishman & Merrick, P.C., of Chicago (Paul D. Carrier, of counsel), for appellee.

JUSTICE BILANDIC delivered the opinion of the court:

This appeal arises from a petition filed in the circuit court of Cook County by the claimant, Marcia Roubik, to confirm in part and vacate in part an arbitration award entered by a panel of the National Association of Securities Dealers (NASD) on February 5, 1993. The arbitration panel ordered the respondents, Merrill Lynch, Pierce, Fenner & Smith, Inc. (Merrill Lynch), Larry H. Lovitsch and Thomas R. Valaika, to pay the claimant $500,000 in compensatory damages. The panel denied the claimant's request for punitive damages. The claimant sought an order from the circuit court confirming the award of compensatory damages and setting aside the denial of

punitive damages. The respondents filed a counterpetition seeking confirmation of the arbitration award in its entirety. The circuit court confirmed the arbitration award in its entirety. On the claimant's appeal, the appellate court reversed in part, holding that the arbitration panel improperly refused to award punitive damages. 285 Ill. App. 3d 217 (1996). We accepted the respondents' petition for leave to appeal. 166 Ill. 2d R. 315(a).

FACTS

In October 1985, the claimant and her now deceased mother executed a customer agreement with Merrill Lynch, a securities brokerage firm, opening a joint cash management account. The agreement contained a provision entitled "Agreement to Arbitrate Controversies," which provided that:

> "it is agreed that any controversy between us arising out of your business or this agreement shall be submitted to arbitration conducted under the provisions of the Constitution and Rules of the Board of Directors of the New York Stock Exchange, Inc. or pursuant to the Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., as the undersigned may elect."

The customer agreement also provided that "this agreement and its enforcement shall be governed by the laws of the State of New York." Respondents Lovitsch and Valaika are employees of Merrill Lynch who handled the claimant's account.

On January 14, 1991, the claimant filed a statement of claim with the NASD charging the respondents with

making unauthorized and unsuitable trades in her account for the purpose of maximizing the respondents' fees and commissions and other misconduct. The claimant alleged that respondents were guilty of willful misrepresentations and omissions, fraud, breach of contract, negligence, breach of fiduciary duty and violations of the rules and regulations of the NASD, the New York Stock Exchange and the American Stock Exchange. The claimant sought recovery of actual damages of not less than $900,000. The claimant also sought an award of punitive damages against the respondents.

The respondents filed a joint statement of answer and executed NASD uniform submission agreements for the arbitration. The submission agreement provided that the undersigned parties:

> "hereby submit the present matter in controversy, as set forth in the attached statement of claim, answers, cross claims and all related counterclaims and/or third party claims which may be asserted, to arbitration in accordance with the Constitution, By-Laws, Rules, Regulations and/or Code of Arbitration Procedure of the sponsoring organization."

The arbitration proceeded in the Midwest Regional Arbitration Office of the NASD in Chicago. At the request of the arbitration panel, the parties provided briefs on the issue of the authority of arbitrators to award punitive damages. The arbitration panel received exhibits and heard several days of testimony. The panel issued its award on February 5, 1993. The panel found the respondents guilty of: (1) lack of supervision; (2) churning; and (3) violation of suitability rules. The panel awarded the

claimant $500,000 in compensatory damages. The award further stated that the arbitrators "find that this misconduct was such that punitive damages should be awarded. However, the panel believes that the law of New York, the forum of the parties, precludes such an award."

On April 5, 1993, the claimant filed a petition in the circuit court to confirm that part of the arbitration award granting compensatory damages and to set aside that part of the award denying punitive damages. The claimant argued that the arbitrators' decision on the punitive damages issue must be set aside because it was contrary to Illinois public policy favoring punitive damages in the securities setting. The claimant asked that the claim be returned to the arbitration panel for entry of an award of punitive damages. In the alternative, the petition asked that the court retain jurisdiction for a jury determination on the punitive damages issue. The petition further asked for interest to be awarded on the compensatory award at the statutory rate of 9% from February 5, 1993. The respondents filed a counterpetition to confirm the arbitration award in its entirety, without interest.

On July 22, 1994, the circuit court issued its order confirming the arbitration award. In particular, the circuit court found that the arbitrators correctly ruled that they did not have the authority to award punitive damages. Further, the court found that Illinois public policy does not favor punitive damages. The court awarded the claimant interest at the statutory rate of 9% on the compensatory damages award from February 5, 1993.

The claimant appealed to the appellate court. The appellate court affirmed the award of compensatory damages and the interest on that award. Relying on the United States Supreme Court decision in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 131 L. Ed. 2d 76, 115 S. Ct. 1212 (1995), the appellate court reversed the circuit court's decision confirming the arbitrators' ruling that they were without authority to award punitive damages. The appellate court remanded the cause to the circuit court with directions to enter an order compelling further NASD arbitration on the issue of punitive damages. 285 Ill. App. 3d 217.

We granted the respondents' petition for leave to appeal. The parties do not raise any issues in this court regarding the award of compensatory damages or the interest award.

ANALYSIS

The question presented in this appeal is whether the arbitration panel's decision on the issue of punitive damages should be set aside. As noted, the parties' contract provided that it was to be governed by the laws of the State of New York. It is undisputed that New York law prohibits arbitrators from awarding punitive damages. See *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976). The respondents argued before the arbitration panel that, pursuant to the explicit terms of the contract, New York law applied and prohibited the arbitrators from awarding punitive damages. The arbitration panel agreed that New York law governed and

that they were therefore without authority to award punitive damages. At the time the arbitrators issued their award, several courts had ruled on the effect on the availability of punitive damages of a New York choice-of-law provision in an arbitration agreement, with conflicting results. The United States courts of appeals for the Seventh and Second Circuits had held that the inclusion of a New York choice-of-law clause precluded an arbitration panel from awarding punitive damages. See *Fahnestock & Co. v. Waltman*, 935 F.2d 512, 517-19 (2d Cir. 1991); *Pierson v. Dean, Witter, Reynolds, Inc.*, 742 F.2d 334, 338-39 (7th Cir. 1984). Other federal courts of appeals, however, had reached the contrary conclusion. See, *e.g.*, *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378, 1387 (11th Cir. 1988); *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056, 1062-63 (9th Cir. 1991).

The United States Supreme Court granted *certiorari* in the case of *Mastrobuono*, to resolve this conflict among the federal courts of appeals. While the claimant's appeal to the appellate court was pending in this case, the Supreme Court announced its decision in *Mastrobuono*, 514 U.S. 52, 131 L. Ed. 2d 76, 115 S. Ct. 1212. Therein, the Court held, on facts very similar to those present here, that a NASD arbitration panel had the authority to award punitive damages, despite the presence of a New York choice-of-law provision in the contract.

In *Mastrobuono*, the petitioners opened a securities trading account with Shearson Lehman Hutton, Inc. (Shearson), by executing Shearson's standard-form client's agreement. That agreement contained an arbitration provision, providing that:

> "any controversy arising out of or relating to [the petitioners'] accounts * * * shall be settled by arbitration in accordance with the rules then in effect, of the National Association of Securities Dealers, Inc., or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange as I may elect."

The agreement in *Mastrobuono* further provided that it was to be " 'governed by the laws of the State of New York.' " *Mastrobuono*, 514 U.S. at 58-59, 131 L. Ed. 2d at 85, 115 S. Ct. at 1217. The petitioners subsequently charged Shearson with mishandling their account and sought compensatory and punitive damages. The claims were submitted to arbitration before a NASD panel, which ruled in favor of the petitioners and awarded them both compensatory and punitive damages. Shearson filed a motion in the United States District Court for the Northern District of Illinois to vacate the award of punitive damages. The district court granted the motion (*Mastrobuono v. Shearson Lehman Hutton Inc.*, 812 F. Supp. 845 (N.D. Ill. 1993)) and the court of appeals affirmed (*Mastrobuono v. Shearson Lehman Hutton, Inc.*, 20 F.3d 713 (7th Cir. 1994)). Both courts reasoned that the agreement provided that New York law applied and New York law prohibits arbitrators from awarding punitive damages.

The Supreme Court reversed. The Court noted that contracting parties have the power to specify in the contract what issues are to be arbitrated. Thus, the parties may limit the issues to be arbitrated by waiving any claim for punitive damages. By the same token, the parties may agree to include claims for punitive damages within the issues to be arbitrated. The Court determined that the

dispositive inquiry was therefore what the parties' contract *said about the arbitrability of the petitioners' claim* for punitive damages. In resolving this inquiry, the Court determined that the New York choice-of-law clause was not, in itself, an unequivocal exclusion of punitive damages claims. Further, the arbitration provision "strongly implie[d]" that an arbitral award of punitive damages was appropriate. The arbitration provision explicitly authorized arbitration in accordance with NASD rules, which gave the arbitrators broad power to award "damages and other relief," and a manual provided to NASD arbitrators specifically provided that arbitrators "can consider punitive damages as a remedy." The *Mastrobuono* Court reasoned that, "as a practical matter," it seemed "unlikely" that the petitioners had any idea that, by signing the standard-form agreement, they might be giving up the right to pursue punitive damages. The Court ultimately concluded that:

> "the best way to harmonize the choice-of-law provision with the arbitration provision is to read 'the laws of the State of New York' to encompass substantive principles that New York courts would apply, but not to include special rules limiting the authority of arbitrators. Thus, the choice-of-law provision covers the rights and duties of the parties, while the arbitration clause covers arbitration; neither sentence intrudes upon the other." *Mastrobuono*, 514 U.S. at 63-64, 131 L. Ed. 2d at 88, 115 S. Ct. at 1219.

Accordingly, the Court held, the arbitral award of punitive damages should have been enforced as within the scope of the contract. *Mastrobuono*, 514 U.S. at 64, 131 L. Ed. 2d at 88, 115 S. Ct. at 1219.

The respondents do not attempt to distinguish *Mastrobuono* from this case, nor do they dispute that it resolves the punitive damages issue in a manner contrary to that of the arbitrators in this case. The respondents nonetheless contend that *Mastrobuono* does not provide a basis for setting aside the arbitrators' ruling on the punitive damages issue. Arbitral awards, the respondents argue, are subject to only limited judicial review and may be set aside only on certain limited grounds. The respondents urge that the arbitrators' resolution of the issue of their authority to award punitive damages, even if erroneous in light of the Supreme Court's decision in *Mastrobuono*, constitutes simply a mistake of law that is not grounds for setting aside the award.

Resolution of this appeal thus turns on the proper standard of review to be applied to the arbitrators' decision on the punitive damages issue. The respondents are correct in their assertion that an arbitration panel's mistake of law will generally not provide grounds to set aside its decision on the merits of a dispute. It is well established that judicial review of an arbitral award is intended to be more limited than appellate review of a trial court judgment. *Rauh v. Rockford Products Corp.*, 143 Ill. 2d 377, 386 (1991); *Garver v. Ferguson*, 76 Ill. 2d 1, 8 (1979); *Merritt v. Merritt*, 11 Ill. 565, 567-68 (1850). A long line of precedent has established that an arbitrator's award will not be set aside because of errors in judgment or mistakes of law or fact. *Rauh*, 143 Ill. 2d at 391; *Garver*, 76 Ill. 2d at 7; *White Star Mining Co. v. Hultberg*, 220 Ill. 578, 601-02 (1906). The rationale for this deferential standard has been explained as follows:

> " 'Arbitrators are judges chosen by the parties to decide the matters submitted to them, finally and without appeal. As a mode of settling disputes it should receive every encouragement from courts of equity. If the award is within the submission, and contains the honest decision of the arbitrators, after a full and fair hearing of the parties, a court of equity will not set it aside for error either in law or fact. A contrary course would be a substitution of the judgment of the Chancellor in place of the judges chosen by the parties, and would make an award the commencement, not the end, of litigation.' " *Garver*, 76 Ill. 2d at 9, quoting *Burchell v. Marsh*, 58 U.S. (17 How.) 344, 349, 15 L. Ed. 96, 99 (1854).

The claimant contends, however, that this deferential standard of review is not applicable in this appeal. She argues that the challenged decision of the arbitrators in this case addressed not the merits of her claim for punitive damages, but rather whether her punitive damages claims were arbitrable. "Arbitrability" refers to whether a particular claim or dispute is subject to arbitration under the parties' agreement. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942, 131 L. Ed. 2d 985, 992, 115 S. Ct. 1920, 1923 (1995). Arbitration is a matter of contract and a party cannot be forced to arbitrate a dispute which the party has not agreed to submit to arbitration. *AT & T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 648, 89 L. Ed. 2d 648, 655, 106 S. Ct. 1415, 1418 (1986). Thus, the arbitrability question requires an interpretation of the parties' contract to determine if there was an agreement to arbitrate a particular dispute.

The standard of review applicable to an arbitrator's decision on a question of arbitrability differs from that applied to an arbitrator's decision on the merits of a dispute. In this case, the parties agree that we must apply federal law to questions concerning arbitrability because the customer agreement "involves commerce" and is therefore governed by the Federal Arbitration Act (FAA) (9 U.S.C. § 1 *et seq.* (1988)). See *Gingiss International, Inc. v. Bormet*, 58 F.3d 328, 331 (7th Cir. 1995); *Bayma v. Smith Barney, Harris Upham & Co.*, 784 F.2d 1023, 1025 (9th Cir. 1986). The FAA creates a "body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24, 74 L. Ed. 2d 765, 785, 103 S. Ct. 927, 941 (1983). Under the FAA and the case law interpreting it, the question of whether a claim is arbitrable is to be independently decided by the courts, unless the parties "clear[ly] and unmistakab[ly]" agree to allow the arbitrator to decide arbitrability. *First Options*, 514 U.S. at 943-45, 131 L. Ed. 2d at 992-94, 115 S. Ct. at 1923-25; *AT & T*, 475 U.S. at 649, 89 L. Ed. 2d at 656, 106 S. Ct. at 1418. Accordingly, where an arbitrator has addressed a question of arbitrability, unless the parties have agreed otherwise, the courts are to apply a *de novo* standard of review to that determination. *First Options*, 514 U.S. at 943, 131 L. Ed. 2d at 993, 115 S. Ct. at 1924. Further, in reviewing an arbitrability question, courts are bound to apply the established federal policy favoring arbitration and to resolve any doubts concerning the scope of arbitrable issues in favor of arbitration. *Moses H. Cone Memorial Hospital*, 460 U.S. at 24-25, 74 L. Ed. 2d at 785, 103 S. Ct. at 941.

We agree with the claimant that the issue of whether the arbitrators had the authority to award punitive damages in this case was a question of arbitrability and, as such, is subject to *de novo* review. The Supreme Court's decisions in *Mastrobuono* and a subsequent case, *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 131 L. Ed. 2d 985, 115 S. Ct. 1920 (1995), compel this conclusion. As noted, in *Mastrobuono*, the Court addressed the same issue presented in this case, whether the inclusion of a New York choice-of-law provision in an arbitration agreement prohibited the arbitrators from awarding punitive damages. The *Mastrobuono* Court described this issue as "the arbitrability of petitioners' claim for punitive damages." *Mastrobuono*, 514 U.S. at 58, 131 L. Ed. 2d at 84, 115 S. Ct. at 1216. The Court then resolved the issue as a question of arbitrability. Applying the principle that ambiguities as to the scope of the arbitration clause must be resolved in favor of arbitration, the Court interpreted the parties' contract to determine if they had agreed to submit punitive damages claims to arbitration. *Mastrobuono*, 514 U.S. at 62, 131 L. Ed. 2d at 87, 115 S. Ct. at 1218, citing *Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior University*, 489 U.S. 468, 103 L. Ed. 2d 488, 109 S. Ct. 1248 (1989). Thus, it is evident that the Supreme Court considers this issue to be a question of arbitrability.

The standard of review to be applied to this issue was clarified by the Supreme Court in *First Options*. In *Mastrobuono*, the Court expressly deferred resolution of the standard of review issue to *First Options*, in which it had recently granted certiorari. *Mastrobuono*, 514 U.S. at 55 n.1, 131 L. Ed. 2d at 83 n.1, 115 S. Ct. at 1215 n.1. In its

opinion in *First Options*, the Court addressed the issue of the proper standard of review to be applied to an arbitrator's decision on arbitrability, referring to *Mastrobuono* as presenting such a question. *First Options*, 514 U.S. at 943, 131 L. Ed. 2d at 992-93, 115 S. Ct. at 1923. The Court held that where an arbitrator has decided a question of arbitrability, unless the parties clearly agree otherwise, the arbitrator's decision is subject to independent review by the courts, without deference to the arbitrator's decision. *First Options*, 514 U.S. at 943, 131 L. Ed. 2d at 993, 115 S. Ct. at 1924. Thus, in *First Options*, the Supreme Court implicitly determined that the issue presented in *Mastrobuono*, whether a New York choice-of-law clause precludes an arbitral award of punitive damages, was subject to independent review by the courts.

We note that the Seventh Circuit Court of Appeals has applied the Supreme Court's decision in *Mastrobuono* to reverse a district court holding that punitive damages were not available in an arbitration proceeding. Although not directly addressing the standard of review issue, the court of appeals implicitly held that the issue of whether the arbitrators could award punitive damages was a matter properly decided by the courts, rather than left to the arbitrators. See *Smith Barney Inc. v. Schell*, 53 F.3d 807, 809 (7th Cir. 1995).

Here, as in *Mastrobuono*, the issue presented is whether the claimant's punitive damages claims are arbitrable under the parties' agreement. The arbitrators determined that the claimant's punitive damages claims were not subject to arbitration under the agreement. This was not a determination of the merits of a dispute, but was a

determination of the arbitrability of a dispute. The rationale of the federal courts for providing a judicial forum for resolution of arbitrability questions is that the arbitrator should not have the power to determine his or her own jurisdiction. *AT & T*, 475 U.S. at 651, 89 L. Ed. 2d at 657, 106 S. Ct. at 1419; *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 547, 11 L. Ed. 2d 898, 903 84 S. Ct. 909, 913 (1964); *Smith Barney, Inc. v. Sarver*, 108 F.3d 92, 96 (6th Cir. 1997). Here, in resolving the punitive damages issue, the arbitrators were called upon to determine the scope of their own authority. Federal law and policy therefore requires that the arbitrators' decision on this issue be subject to independent review by the courts.

The respondents do not contend that the parties in this case agreed to allow the arbitrators to decide questions of arbitrability. The dissent nonetheless purports to find such an agreement in the use of the word "any" in the arbitration clause. The dissent's conclusion wholly ignores the Supreme Court's directives on this question. The dissent correctly notes that, in *First Options*, the Court recognized that contracting parties may agree to allow the arbitrator to decide questions of arbitrability. The Court went on, however, to explain that "[c]ourts should not assume that the parties agreed to arbitrate arbitrability unless there is 'clea[r] and unmistakabl[e]' evidence that they did so." *First Options*, 514 U.S. at 944, 131 L. Ed. 2d at 994, 115 S. Ct. at 1924, quoting *AT & T*, 475 U.S. at 649, 89 L. Ed. 2d at 656, 106 S. Ct. at 1418. Because of the "significance of having arbitrators decide the scope of their own powers," the Court emphasized that the presumption will be that the parties did not agree to arbitrate questions of arbitrability. Thus, "silence or

ambiguity" on the point will not be interpreted as giving the arbitrators that power. *First Options*, 514 U.S. at 943-45, 131 L. Ed. 2d at 992-94, 115 S. Ct. at 1923-24. The arbitration agreement in this case is, at best, silent on the question of who should decide questions of arbitrability. Under the clear mandate of *First Options*, we must therefore hold that the arbitrability question presented in this case is to be independently decided by the courts. See *Cogswell v. Merrill Lynch, Pierce, Fenner & Smith*, 78 F.3d 474, 480 (10th Cir. 1996). The mere use of the word "any" cannot suffice to establish the "clear and unmistakable" evidence required by *First Options*.

The dissent also finds that a provision of the NASD Code evidences the parties' intent in this case to submit arbitrability questions to arbitration. Again, the dissent's superficial reasoning misses the mark. Section 35, the NASD Code provision relied upon by the dissent, empowers the arbitrators to interpret the applicability of "all provisions under this Code." The cases cited by the dissent, *Bybyk*, *Freel* and *Sacharow*, used section 35 to find that the parties in those cases agreed to allow the arbitrators to decide whether NASD Rule 15 operated to time-bar certain claims for arbitration. See *PaineWebber Inc. v. Bybyk*, 81 F.3d 1193, 1200-02 (2d Cir. 1996) ("[section 35 of] the NASD Code itself grants to the arbitrators the power to interpret and apply section 15"); *FSC Securities Corp. v. Freel*, 14 F.3d 1310, 1312-13 (8th Cir. 1994) ("In no uncertain terms, section 35 commits interpretation of all provisions of the NASD Code to the arbitrators"); *Smith Barney Shearson, Inc. v. Sacharow*, Nos. 234, 235 cons. (N.Y. December 4, 1997) (following *Bybyk* and *Freel* and holding that section 35 empowers the arbitrators to decide

whether the Rule 15 time limitation is applicable). Thus, the only proposition these cases arguably stand for is that, when an arbitrability question requires interpretation of an NASD rule, section 35 empowers the arbitrators to decide that question. The arbitrability question presented here, whether a New York choice-of-law provision precludes the arbitrators from awarding punitive damages, does not hinge on the interpretation of an NASD rule. Section 35, and the cases applying it, therefore have no applicability in this case. Moreover, even if this section were applicable, we note that the interpretation of section 35 adopted in *Bybyk* and *Freel* has been rejected by other federal courts of appeal, including the Seventh Circuit Court of Appeals. See, *e.g.*, *Edward D. Jones & Co. v. Sorrells*, 957 F.2d 509, 514 n.6 (7th Cir. 1992) ("we do not believe that [section 35] is a clear and unmistakable expression of the parties' intent to have the arbitrators, and not the court, determine which disputes the parties have agreed to submit to arbitration"); *Cogswell v. Merrill Lynch, Pierce, Fenner & Smith*, 78 F.3d 474, 477 (10th Cir. 1996) (noting that *Freel* is one of a "substantial minority" of courts holding that the arbitrators have the power to decide if section 15 time-bars claims) (and cases cited therein). The dissent's position is thus entirely without merit.

The respondents contend that, even if the issue in this case is properly characterized as one of arbitrability, deferential review of the arbitrators' decision is still required because the issue involves "procedural arbitrability," not "substantive arbitrability." The Supreme

Court has held that, while issues of "substantive arbitrability" are to be decided by the courts, issues of "procedural arbitrability" are generally to be left to the arbitrators. The Court has stated that, "[o]nce it is determined * * * that the parties are obligated to submit the subject matter of a dispute to arbitration, 'procedural' questions which grow out of the dispute and bear on its final disposition should be left to the arbitrator." *Wiley & Sons*, 376 U.S. at 557, 11 L. Ed. 2d at 909, 84 S. Ct. at 918. In *Wiley & Sons*, the procedural question the Court held should be left to the arbitrator was whether certain procedural prerequisites to arbitration, required by the parties' collective-bargaining agreement, had been satisfied. Other courts have held that the issue of a party's compliance with time limits for submitting a claim to arbitration is a procedural matter properly left to the judgment of the arbitrator. See, *e.g.*, *Local 285 v. Nonotuck Resource Associates, Inc.*, 64 F.3d 735, 739-41 (1st Cir. 1995); but see *Smith Barney Inc. v. Schell*, 53 F.3d 807, 809 (7th Cir. 1995) (whether claimants' arbitration claims are time-barred is to be decided by the courts).

Respondents argue here that the question of whether the New York choice-of-law clause precludes the arbitrators from awarding punitive damages is simply a matter of procedure, which is therefore properly left to the arbitrators. We disagree. This issue addresses the scope of the arbitrators' authority and is therefore a matter independently reviewable by the courts. See *Cogswell v. Merrill Lynch, Pierce, Fenner & Smith*, 78 F.3d 474, 476-77 (10th Cir. 1996); *Edward D. Jones & Co. v. Sorrells*, 957 F.2d 509, 514 (7th Cir. 1992) (defining the limits of arbitral jurisdiction

is generally the function of courts, not arbitrators). Moreover, the Supreme Court's opinions in *Mastrobuono* and *First Options* reveal that the Court has determined this issue to be a question of arbitrability independently reviewable by the courts.

Accordingly, we find that, because the issue presented in this case is a matter of arbitrability, and the parties did not clearly agree to allow the arbitrators to decide arbitrability, the arbitrators' decision on this issue is subject to independent review by the courts. The appellate court therefore properly applied *Mastrobuono* to set aside the arbitrators' determination that the claimant's punitive damages claims were not arbitrable. The judgment of the appellate court affirming in part and reversing in part the circuit court's judgment and remanding with directions to the circuit court to order further NASD arbitration on the issue of punitive damages is affirmed.

Appellate court judgment affirmed.

Justice HEIPLE, dissenting:

It is a fundamental rule of contract construction that a judge deciding a commercial dispute should first read the contract establishing the relationship between the parties and then – and only then – think great thoughts. In its misguided disposition of this case, the majority has put the proverbial cart before the horse: the majority opinion fails to recognize that parties to a contract may themselves provide that an arbitrator, and not a judge, shall decide whether an issue is arbitrable. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943, 131 L. Ed. 2d 985, 993 115 S. Ct. 1920, 1923-24 (1995). Instead, in some ill-conceived attempt to do justice, the majority has decided

to review *de novo* whether a given issue is arbitrable without first considering whether the parties agreed to submit the question to arbitration.

Did the parties agree to arbitrate questions of arbitrability, including the issue of whether the arbitrators had the power to award punitive damages? There are in fact two written agreements between the parties, a "Customer Agreement" and a "Cash Management Agreement," each of which contains the identical "Agreement to Arbitrate Controversies" clause:

> "Except to the extent that controversies involving claims arising under the Federal securities law may be litigated, it is agreed that *any* controversy between us arising out of your business or this agreement shall be submitted to arbitration conducted under the provisions of the Constitution and Rules of the Board of Directors of the New York Stock Exchange, Inc. or pursuant to the Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., as the undersigned may elect." (Emphasis added.)

These provisions evidence the parties' intent to arbitrate all issues, including arbitrability. With the stated exception of federal securities claims, the language is all-inclusive, categorical, and unconditional. The word "any" is broad enough to encompass disputes over whether a particular claim is within the scope of arbitration. See 1 Oxford English Dictionary 539 ("In affirmative sentences ['any'] asserts concerning a being or thing of the sort named, without limitation as to which, and thus constructively of *every* one of them"). Thus, an objective reading

of the parties' agreements leads inexorably to the conclusion that the parties intended to arbitrate issues of arbitrability.

Moreover, the plaintiff elected to submit the dispute for arbitration with the National Association of Securities Dealers (NASD). The submission agreement provided that the parties "hereby submit the present matter in controversy * * * to arbitration in accordance with the Constitution, By-Laws, Rules, Regulations and/or Code of Arbitration Procedure of the [NASD]."[1] Section 1 of the NASD Code provides that the Code "is prescribed * * * for the arbitration of any dispute, claim, or controversy" between members and their customers.

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[1] Based on a superficial reading of *First Options*, the majority cavalierly declares that "[t]he arbitration agreement in this case is, at best, silent on the question of who should decide questions of arbitrability" and that the use of the word "any" in the agreement is not "clear and unmistakable" evidence of the parties' intent to arbitrate arbitrability. 181 Ill. 2d at 386. *First Options* indeed holds that courts may not assume that parties agreed to arbitrate arbitrability unless there is "clea[r] and unmistakabl[e]" evidence that the parties so agreed. *First Options*, 514 U.S. at 944, 131 L. Ed. 2d at 994, 115 S. Ct. at 1924, quoting *AT & T*, 475 U.S. at 649, 89 L. Ed. 2d at 656, 106 S. Ct. at 1418. But the precise issue decided by the Court in that case was whether a party (Kaplan) could be compelled to arbitrate personal claims when only his wholly owned investment company (MK Investments, Inc.), and not the party personally, signed the agreement to arbitrate. *First Options*, 514 U.S. at 941, 131 L. Ed. 2d at 991, 115 S. Ct. at 1922. Because Kaplan never signed an agreement to arbitrate, the Court held that Kaplan "did not clearly agree to submit the question of arbitrability to arbitration." *First Options*, 514 U.S. at 947, 131 L. Ed. 2d at 995, 115 S. Ct. at 1925.

The NASD Code itself grants the arbitrators the power to decide issues of arbitrability:

> "The arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code and to take appropriate action to obtain compliance with any ruling by the arbitrator(s)."

NASD Code of Arbitration Procedure, NASD Manual 3735. By adopting the NASD Code to govern their dispute, the parties further agreed to commit all issues, including issues of arbitrability, to the arbitrators. See *PaineWebber Inc. v. Bybyk*, 81 F.3d 1193, 1202 (2d Cir. 1996); *FSC Securities Corp. v. Freel*, 14 F.3d 1310, 1312-13 (8th Cir. 1994) ("The parties' adoption of this provision is a 'clear and unmistakable' expression of their intent to leave the question of arbitrability to the arbitrators").[2]

The emphatic, all-inclusive language of the arbitration clauses in the instant agreement and the parties' adoption of the NASD Code are not sufficient to persuade the majority of the parties' intent and commitment to arbitrate issues of arbitrability. The majority wants more. Here is more. When deciding whether the parties agreed to arbitrate a certain matter including arbitrability, courts should apply ordinary state-law principles that govern the formation of contracts. *First Options*, 514 U.S. at 944,

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[2] The majority feebly seeks to limit the holdings of *Bybyk* and *Freel* to instances where arbitrators are called on to interpret provisions of the NASD Code. However, the NASD Code by its own terms was promulgated to govern the arbitration of "any" dispute between the parties, including disputes over arbitrability, and thus section 35 clearly grants the arbitrators the power to decide arbitrability issues.

131 L. Ed. 2d at 993, 115 S. Ct. at 1924. Here the parties' agreement and its enforcement is to "be governed by the law of the State of New York." The highest court in the State of New York has held that parties "clearly and unmistakably" agree to arbitrate arbitrability when the parties have agreed to resolve "any controversy" by arbitration in accordance with the rules of the NASD:

> "Coupled with the plain and sweeping language of the arbitration clause in the instant agreements and the analysis of the persuasive authorities, Section 35 of the NASD Code (now Rule 10324) buttresses our conclusion concerning the parties' intent and commitment to arbitrate the issue of arbitrability."

Smith Barney Shearson, Inc. v. Sacharow, Nos. 234, 235 cons. (N.Y. December 4, 1997). Thus, under the relevant state law, the language of the arbitration agreement and the provision of the NASD manifest the parties' intent to submit the arbitrability issue to arbitration.

Thus, the parties agreed to relinquish their right to have a court decide the merits of their dispute, and instead expressly agreed to submit *all* questions – including arbitrability – to arbitration. A party may still ask a court to review an arbitrator's decision, but the court will set that decision aside *only* where the decision is tainted by corruption, fraud or misconduct, or amounts to a manifest disregard of the law. See *First Options*, 514 U.S. at 942, 131 L. Ed. 2d at 992, 115 S. Ct. at 1923; 9 U.S.C. § 10 (1994); 710 ILCS 5/12 (West 1996). The only issue left is whether the arbitrators interpreted the law in good faith; if they did, their interpretation – even if mistaken – is conclusive. *Rauh v. Rockford Products Corp.*, 143 Ill. 2d 377, 391 (1991); *Garver v.*

Ferguson, 76 Ill. 2d 1, 7-8 (1979); *Merritt v. Merritt*, 11 Ill. 565, 567-68 (1850). Here the arbitrators concluded in good faith that New York law precluded an arbitration panel from awarding punitive damages, and this conclusion was legally correct at the time of the arbitration award. Accordingly, the appellate court's judgment purporting to "remand" the cause for further arbitration should be reversed.

In affirming the appellate court, the majority has dramatically expanded the scope of appellate review of arbitration awards and, in so doing, has grossly misstated the law in at least three respects. (1) The majority writes that "the issue of whether the arbitrators had the authority to award punitive damages in this case was a question of arbitrability and, as such, is subject to *de novo* review." 181 Ill. 2d at 383. This is erroneous: if the parties agree to arbitrate issues of arbitrability, "then the court's standard for reviewing the arbitrator's decision about *that* matter should not differ from the standard courts apply when they review any other matter that parties have agreed to arbitrate." *First Options*, 514 U.S. at 943, 131 L. Ed. 2d at 993, 115 S. Ct. at 1923. (2) The majority states that "[h]ere, in resolving the punitive damages issue, the arbitrators were called upon to determine the scope of their own authority. Federal law and policy therefore requires that the arbitrators' decision on this issue be subject to independent review by the courts." 181 Ill. 2d at 385. Again, this is incorrect: the Federal Arbitration Act establishes an emphatic national policy *favoring* arbitration which is binding on all courts, state and federal. See *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24-25, 74 L. Ed. 2d 765, 785, 103 S. Ct. 927, 941 (1983)

("questions of arbitrability must be addressed with a healthy regard for the federal policy * * * [and] any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration"). (3) The majority holds that "[t]his issue [of punitive damages] addresses the scope of the arbitrators' authority and is therefore a matter independently reviewable by the courts." 181 Ill. 2d at 389. Wrong again: when, as here, there is "clear and unmistakable" evidence from the arbitration agreement that the parties intended that the question of arbitrability be decided by the arbitrators, the court *must* defer to the arbitrators' decision. *First Options*, 514 U.S. at 944, 131 L. Ed. 2d at 994, 115 S. Ct. at 1924.

In sum, the majority has misstated the law, misconstrued the facts and has undermined freedom of contract and the public policy favoring arbitration. Arbitration is a matter of consent, not coercion, and parties are free to write their arbitration agreements as they wish. The goal of arbitration is to avoid protracted litigation in the courts, and the parties to an arbitration agreement bargain for this efficiency. By adopting a *de novo* standard of review, the majority has rendered private arbitration nothing more than an expensive precursor to traditional litigation, rather than an alternative means for resolving commercial disputes. I dissent.

[LOGO]

SUPREME COURT OF ILLINOIS
SUPREME COURT BUILDING
SPRINGFIELD 62701

March 30, 1998

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Mr. Peter A. Cantwell
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No. 82752 – Marcia M. Roubik, appellee, v. Merrill Lynch, Pierce, Fenner & Smith Inc. et al., appellants. Appeal, Appellate Court, First District.

The Supreme Court today DENIED the petition for rehearing in the above entitled cause.

The mandate of this Court will issue to the appropriate Appellate Court and/or Circuit Court or other agency on April 9, 1998.

Illinois Appellate Court, First District

MARCIA M. ROUBIK, Petitioner-Appellant and Cross-Appellee, v. MERRILL LYNCH, PIERCE, FENNER AND SMITH, INC., et al.,

Respondents-Appellees and Cross-Appellants.

First District (3rd Division) No. 1-94-2774

Affirmed in part, and reversed in part and remanded with directions.

Opinion filed May 1, 1996. –
Rehearing denied January 3, 1997.

Appeal from the Circuit Court of Cook County; the Hon. Dorothy K. Kinnaird, Judge, presiding.

Paul D. Carrier, of Chicago, for petitioner.

Peter A. Cantwell and Stephen F. Boulton, both of Chicago, for respondents.

Roland W. Burris, Attorney General, of Chicago (Rosalyn B. Kaplan, Solicitor General, and Tanya Solov, Special Assistant Attorney General, of Counsel), for *Amicus Curiae*.

JUSTICE TULLY delivered the opinion of the court:

Petitioner, Marcia M. Roubik, appeals from an order of the circuit court of Cook County denying her petition to vacate a National Association of Securities Dealers (NASD) arbitration panel ruling that the law of New York precludes an award of punitive damages in this case and granting the cross-petition of respondents, Merrill Lynch, Pierce, Fenner & Smith, Inc. (Merrill Lynch), Larry H. Lovitsch and Thomas R. Valaika, to confirm said ruling. Petitioner also appeals from the circuit court's denial of

her alternative petition that she be granted a jury determination of any claim held to be non-arbitrable. Respondents cross-appeal from the circuit court's award of interest for the period of time after the entry of the arbitration award, but prior to the circuit court's entry of a confirming judgment. The Illinois Secretary of State's Securities Department has filed an *amicus* brief in this case. Jurisdiction is vested in this court pursuant to Supreme Court Rule 301. 155 Ill.2d R. 301.

For the reasons which follow, we affirm in part and reverse in part and remand with directions.

In October of 1985, petitioner and her now-deceased mother had a joint account with Merrill Lynch having a total value at that time of around $787,000. Respondents, in essence, assert that Lovitsch and Valaika, brokers employed for Merrill Lynch, a securities brokerage, "churned" the account in order to generate excessive commissions. According to petitioner, this churning of the account and its attendant brokerage fees accompanied with mismanagement of the investment portfolio caused a loss of approximately $1.67 million from 1985 through 1988.

Petitioner subsequently initiated arbitration proceedings against respondents as was called for in the "Customer Agreement" she signed with Merrill Lynch. Petitioner sought both compensatory damages and punitive damages. The arbitration panel awarded petitioner $500,000 in compensatory damages. However, the panel did not award punitive damages in spite of its finding that such damages were appropriate in this case. The panel based this decision on the fact that the Customer

Agreement contained a provision that stated that the "Agreement and its enforcement shall be governed by the laws of the State of New York." In 1976, the New York Court of Appeal decided that in New York the power to award punitive damages is limited to judicial tribunals and may not be exercised by arbitrators. (See *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976). Thus, the arbitrators concluded that as New York law applied to the agreement the *Garrity* rule precluded their awarding punitive damages to petitioner.

Petitioner subsequently filed an action in the circuit court seeking enforcement of the arbitrators' $500,000 compensatory award as well as reversal of the panel's determination that punitive damages were unavailable. The circuit court affirmed *in toto* the arbitration panel's award of compensatory damages and determination that punitive damages were not permitted under the terms of the Customer Agreement. The circuit court also awarded petitioner prejudgment interest from the time period after the entry of the arbitration award, but prior to the circuit court's entry of a confirming judgment. In so doing, the circuit court relied heavily on the decision of the United States Court of Appeals for the Seventh Circuit in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 20 F.3d 713 (7th Cir.1994), which has subsequent to the filing of the appellate briefs in this case been reversed by the United States Supreme Court in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. ___, 131 L.Ed. 2d 76, 115 S.Ct. 1213 (1995).

Petitioner argues that the circuit court erred in confirming the arbitrators' decision that they were precluded by New York law from awarding punitive damages in

this case. We agree. We note that as this case involves purely legal questions our review of it is *de novo*. *Benedictine Sisters of the Sacred Heart v. Department of Revenue*, 155 Ill. App. 3d 325 (1987); see also T. O'Neill & S. Brody, *Taking Standards of Appellate Review Seriously: A Proposal to Amend Rule 341*, 83 Ill. B.J. 512 (1995).

As respondents noted in their brief, "[t]he Customer Agreement in the case at bar is quite parallel to that construed in *Mastrobuono*." We agree and believe the Supreme Court's recent decision in *Mastrobuono* is directly on point and controlling of this case.

In *Mastrobuono*, two clients opened a securities trading account with a securities dealer in 1985 by executing, in Illinois, the broker's standard-form client agreement. Under the agreement's choice-of-law provision, the agreement was to be governed by the "laws of the State of New York." The agreement's arbitration provision authorized arbitration in accordance with the rules of (1) NASD, or (2) either the New York Stock Exchange or the American Stock Exchange. The agreement itself contained no express reference to claims for punitive damages. In 1989, the clients filed an action in the United States District Court for the Northern District of Illinois against the brokerage and several individuals. The district court stayed the court action and compelled arbitration pursuant to NASD rules. A NASD arbitration panel ruled in favor of the clients and awarded both compensatory and punitive damages. The district court vacated the award of punitive damages and in doing so held that the arbitration panel had not been authorized to award punitive damages under New York's *Garrity* rule. The Seventh

Circuit affirmed the district court. The Supreme Court reversed both the Seventh Circuit and the district court.

In reversing the lower courts, the Supreme Court held that the punitive damages award was enforceable as within the scope of the client agreement because (1) the agreement's arbitration provision strongly implied that an arbitral award of punitive damages was appropriate; (2) the agreement's choice-of-law provision was not, in itself, an unequivocal exclusion of punitive damages claims, but at most introduced an ambiguity into the arbitration agreement; (3) in light of such doubt or ambiguity, it is improper to impute to the clients an intent to give up an important substantive right; and (4) a reading of the choice-of-law and arbitration provisions as together expressing an intent to preclude a punitive damages award would violate the principle that a document should be read to give effect to all of the document's provisions and to render such provisions consistent with each other.

In both *Mastrobuono* and the case *sub judice* the client agreements contained almost identical arbitration and choice-of-law provisions selecting New York law. Both standard-form contracts, which contain no express reference to punitive damage claims, elect to pursue arbitration in accordance with the rules of NASD, or either the New York Stock Exchange or the American Stock Exchange. The NASD rules clearly allow for the award of punitive damages. Thus, we see no distinction between the two cases that would cause us to depart from the Supreme Court's reasoning that the choice-of-law provision merely represented a convenient substitute for the conflict-of-laws analysis that otherwise would determine

what law to apply to disputes arising out of the contractual relationship (*Mastrobuono*, 514 U.S. at ___, 131 L. Ed. 2d at 85), 115 S. Ct. at 1217) and *not* an unequivocal exclusion of punitive damages (*Mastrobuono*, 514 U.S. at ___, 131 L. Ed. 2d at 86, 115 S. Ct. at 1217).

Moreover, we do not see any reason to stray from "the common-law rule of contract interpretation that a court should construe ambiguous language against the interest of the party that drafted it." (*Mastrobuono*, 514 U.S. at ___, 131 L. Ed. 2d at 87, 115 S. Ct. at 1219, citing *United States Fire Insurance Co. v. Schnackenberg*, 88 Ill.2d 1, 4, 429 N.E.2d 1203, 1205 (1981); *Graff v. Billet*, 64 N.Y.2d 899, 902, 477 N.E.2d 212, 213-14 (1984). Another cardinal rule of contract construction is that a document should be read to give effect to all its provisions and to render them consistent with one another. *Mastrobuono*, 514 U.S. at ___, 131 L. Ed. 2d at 88, 115 S. Ct. at 1219, citing *In re Halas*, 104 Ill. 2d 83, 92, 470 N.E.2d 960, 964 (1984); *Crimmins Contracting Co. v. City of New York*, 74 N.Y.2d 166, 172-73, 542 N.E.2d 1097, 1100 (1989); *Trump-Equitable Fifth Avenue Co. v. H.R.H. Construction Corp.*, 106 App. Div. 2d 242, 244, 485 N.Y.S.2d 65, 67 (1985); Restatement (Second) of Contracts § 203(a) and Comment *b*, § 202(5) (1979). Here, as was the situation in *Mastrobuono*, the brokerage house drafted the ambiguous contract and, thus, it cannot now claim the benefit of the doubt. To allow such a construction would conflict with the common-law's twin policies of protecting the party who did not choose the ambiguous language and rendering contractual provisions consistent with each other. (*Mastrobuono*, 514 U.S. at ___, 131 L. Ed. 2d at 87-88, 115 S. Ct. at 1218-19. This result is especially compelling in a situation such as we have here

where "it seems unlikely that [the clients] were actually aware of New York's bifurcated approach to punitive damages, or that they had any idea that by signing a standard-form agreement to arbitrate disputes they might be giving up an important substantive right." (*Mastrobuono*, 514 U.S. at ___, 131 L. Ed. 2d at 87-88, 115 S. Ct. at 1219. Accordingly, we find the circuit court erred in confirming the arbitrators' decision that they were precluded by New York law from awarding punitive damages. On remand, we direct the circuit court to enter an order compelling further NASD arbitration on the issue of punitive damages and staying further action in the circuit court until such arbitration proceedings can be completed.

Still to be considered is respondents' contention on cross-appeal that the circuit court erred in its award of interest for the period of time after the entry of the arbitration award, but prior to the circuit court's entry of a confirming judgment. We cannot agree with this proposition and believe the circuit court decision was proper under section 41(h) of the NASD Code of Arbitration Procedure, which is incorporated into the Customer Agreement. Section 41(h) provides as follows:

> "(h) All monetary awards shall be paid within thirty (30) days of receipt unless a motion to vacate has been filed with a court of competent jurisdiction. An award shall bear interest from the date of the award: (i) if not paid within thirty (30) days of receipt, (ii) if the award is the subject of a motion to vacate which is denied, or (iii) as specified by the arbitrator(s) in the award. Interest shall be assessed at the legal rate, if any, then prevailing in the state where

the award was rendered, or at a rate set by the arbitrator(s)."

The transmittal letter, dated February 8, 1993, clearly references section 41 and provides for an award of interest with qualification. Since the award was entered in Illinois and the compensatory damages award was not paid within 30 days, section 41(h) requires payment of interest from the award date until paid at the lawful rate of 9% under section 2 – 1303 of the Code of Civil Procedure (735 ILCS 5/2 – 1303 (West 1994)). Therefore there was no error by the circuit court on this point.

In light of the foregoing, we affirm in part and reverse in part and remand this cause to the circuit court with directions.

Affirmed in part; reversed in part and remanded with directions.

RIZZI, P.J., and CERDA, J., concur.

IN THE APPELLATE COURT
OF ILLINOIS
FIRST JUDICIAL DISTRICT

MARCIA M. ROUBIK, Petitioner-Appellant/ Cross-Appellee, v. MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC., LARRY H. LOVITSCH and THOMAS R. VALAIKA, Respondents-Appellees/ Cross-Appellants.	)	No. 1-94-2774 (Filed Jan. 3, 1997)

ORDER

This case coming to be heard on the court's own action, the court being fully advised in the premises:

IT IS HEREBY ORDERED THAT:

(1) This court's order of October 7, 1996, wherein this court granted respondents' petition for rehearing is stricken; and

(2) Respondents' petition for rehearing is denied.

/s/ Michael J. Gallagher
Justice

/s/ John P. Tully
Justice

Justice

I WOULD GRANT THE PETITION AND AFFIRM THE CIRCUIT COURT

/s/ David Cerda

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT, CHANCERY DIVISION

MARCIA M. ROUBIK, Petitioner, v. MERRILL LYNCH, PIERCE, FENNER & SMITH INC., LARRY H. LOVITSCH and THOMAS R. VALAIKA, Respondents.	)	No. 93 CH 4055

FINAL ORDER AND JUDGMENT

THIS CAUSE coming to be heard upon the Petition to Confirm in Part and Vacate in Part An Arbitration Award filed by Petitioner Marcia Roubik on or about April 30, 1993; Petitioner's Motion for the Entry of Judgment with Accrued Interest; the Counter-Petition to Confirm An Arbitration Award filed by Respondents Merrill Lynch, Pierce, Fenner & Smith Inc., Larry H. Lovitsch and Thomas R. Valaika on or about October 25, 1993; and the Respondents' Motion to Dismiss and to Confirm the Arbitration Award Without Interest, the parties having submitted pleadings and briefs to the Court and the Court having heard the argument of counsel in support and in opposition to all pending petitions and motions, with the Court being otherwise duly advised in the premises, this Court finds and enters final judgment and disposes of all pending petitions and motions as follows:

FOR THE REASONS STATED IN OPEN COURT ON JULY 13, 1994, the COURT FINDS AS FOLLOWS:

1. This Court has subject matter jurisdiction of the case as well as personal jurisdiction of the parties, and venue is proper in the Circuit Court of Cook County, Illinois, County Department, Chancery Division.

2. There is no dispute as to any material fact.

3. On or about January 14, 1991, Petitioner Marcia Roubik filed a Statement of Claim with the National Association of Securities Dealers, Inc. ("NASD"), claiming misconduct by Respondents Merrill Lynch, Pierce, Fenner & Smith Inc., Larry H. Lovitsch and Thomas R. Valaika and seeking compensatory and punitive damages. *Marcia M. Roubik v. Merrill Lynch, Pierce, Fenner & Smith Inc., Larry H. Lovitsch and Thomas R. Valaika,* NASD Arbitration No. 91-00169.

4. On February 5, 1993, after approximately two weeks of hearings conducted in Chicago, Illinois, the arbitrators entered an award in the amount of $500,000.00 in favor of Marcia Roubik. With respect to punitive damages, the arbitrators ruled as follows:

   > The undersigned arbitrators further find that this misconduct was such that punitive damages should be awarded. However, the panel believes that the law of New York, the forum of the parties, precludes such an award . . . Claimant, Marcia M. Roubik's claims for punitive damages and attorney's fees are hereby denied and dismissed with prejudice.

5. This Court finds that Judgment should be entered upon the Award.

6. This Court finds that the arbitrators in NASD Arbitration No. 91-00169 correctly ruled that they did not

have the authority to award punitive damages in the arbitration award entered in that proceeding.

7. This Court does not find the existence of any Illinois public policy favoring punitive damages. Instead, the Court finds that the public policy of Illinois does not favor punitive damages.

8. The Court does not find that punitive damages are authorized by the Uniform Submission Agreements executed by the Respondents, and rejects application of Petitioner's cited case law, *Neuberger & Berman v. Donaldson, Lufkin & Jenrette Securities Corp.*, Index No. 16833/91 (Supreme Court of New York, New York County, April 6, 1992).

9. This Court finds that because the arbitration award was not paid within 30 days of receipt by the Respondents, under Section 41(h) of the Code of Arbitration Procedure of the National Association of Securities Dealers, Inc., applicable case law and the provisions of 735 ILCS 5/2-1303, Petitioner is entitled to statutory interest on the arbitration award from and after February 5, 1993 at the nine percent per annum rate set by the legislature in 735 ILCS 5/2-1303 (1993).

10. The Court finds that each party should bear its own costs.

UPON THESE FINDINGS IT IS HEREBY ORDERED:

A. Respondents' Motion to Dismiss and to Confirm the Arbitration Award Without Interest is granted as to confirmation of the Arbitration Award served by the National Association of Securities Dealers, Inc. on or about February 5, 1993 in Arbitration No. 91-00169 ("Arbitration Award"), and denied in all other respects.

B. Petitioner's Petition to Confirm in Part and Vacate in Part Arbitration Award is granted in part to the extent of confirmation of the Arbitration Award, and for an award of interests upon said Arbitration Award from and after February 5, 1993, and for entry of judgment thereon, and is denied in all other respects;

C. Petitioner's Motion for Entry of Judgment with Accrued Interest is moot.

D. The Counter-Petition to Confirm An Arbitration Award filed by Respondents is granted as to confirmation of the Arbitration Award of compensatory damages and the ruling of the arbitration panel on punitive damages, and is denied in all other respects.

E. The Arbitration Award of compensatory damages is hereby confirmed as a judgment of this Court in the amount of FIVE HUNDRED THOUSAND AND NO/100 ($500,000.00) in favor of Petitioner Marcia M. Roubik and jointly and severally against Respondents Merrill Lynch, Pierce, Fenner & Smith Inc., Larry H. Lovitsch and Thomas R. Valaika, and judgment is hereby entered;

F. As a part of said judgment, Petitioner is awarded statutory interest upon the arbitration award at a rate of nine percent (9%) *per annum* from and after February 5, 1993 until the arbitration award is satisfied or said award of interest is otherwise terminated. The calculation, satisfaction or termination of said award of interest shall be governed by the provisions in Illinois law for interest on judgments and awards.

G. Each party is to bear its own costs.

H. By agreement of the parties by and through their respective counsel before the Court, the enforcement of this Order and the judgment entered herein is stayed for a period of thirty-five (35) days from entry. The stay hereby entered shall not effect the time limits set by Illinois law for filing of post-judgment motions or a notice of appeal from this Order.

SO ORDERED.

/s/ Dorothy Kirie Kinnaird
DOROTHY KIRIE KINNAIRD
Circuit Court Judge

Dated: July 22, 1994

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT – CHANCERY DIVISION

MARCIA ROUBIK,	)	
Plaintiff,	)	
vs.	)	
MERRILL LYNCH,	)	No. 93 CH 4055
Defendant.	)	

REPORT OF PROCEEDINGS had at the hearing of the above-entitled cause, before the Honorable DOROTHY KIRIE KINNAIRD, Judge of said court on the 13th day of July, A.D., 1994.

PRESENT:

MR. PETER CANTWELL,
MR. STEVEN BOULTON,
on behalf of the Plaintiff;

MR. PAUL CARRIER,
on behalf of Defendant.

Diane O. Washington, CSR,
Official Court Reporter
Circuit Court of Cook County
Chancery Division
084-00238

[p. 2] THE CLERK: 93 CH 4055, Roubik versus Lynch.

THE COURT: Good afternoon, counsel.

I hope the rescheduling wasn't too much of an inconvenience for you.

If you could just identify yourselves for the record, please.

MR. CANTWELL: For the record, I'm Peter Cantwell, along with Steven Boulton on behalf of Merrill Lynch, Defendant.

MR. CARRIER: And for the record, I'm Paul Carrier for the claimant in this case – excuse me – Petitioner, Marcia Roubik.

THE COURT: Okay. Gentlemen, I'm going to give a brief oral ruling for the record, and then ask you to prepare an order at the conclusion, either today or you can submit a typed order.

This case is before the Court on the petition to confirm in part and vacate in part an arbitration award of the National Association of Security Dealers, dated February 5th, 1993, in Case No. 91-169.

The Court also has before it a motion to dismiss and to confirm arbitration award without interest and a counter-petition to confirm an arbitration award which has been filed by the [p. 3] Defendant.

In addition to these three main Pleadings, the Court has in front of it a series of answers, responses, replies, as well as memoranda, supplemental memoranda and additional authority, and no small amount of cases. Well over 100 cases have been cited to the Court in regard to the various issues in this case.

When the case was argued before me on June 10th, I asked both sides to present to me proposed findings of fact and conclusions of law, and how they wanted the actual judgment order to read in this case.

Apparently, there must have been some confusion about exactly what I wanted because I received from Plaintiff's counsel about 45 pages of Proposed findings of fact and conclusions of law which were really in the nature of a brief, and a two-page order and judgment which in form was essentially what I was looking for.

I received from Defendant's counsel an eleven-page, single spaced document entitled "Final Judgment Order" which also was in the nature pretty much of a brief.

The order that I would like to have entered [p. 4] today or tomorrow, if you want to bring in a typed order, I would ask Plaintiff's counsel to prepare and to make it in line, as far as form, with the order and judgment that Plaintiff's counsel submitted with the longer document.

There are a series of issues and sub-issues in this case, not all of which this Court believes require ruling by this Court.

Initially, the parties agreed in argument before me on June 10th that there's no longer an issue as to whether there's a time bar regarding Defendant's response to Plaintiff's petition; and the Court will not address that in this ruling.

The main issue in the case involves a choice of law issue, and this Court's relying on the following cases, among others, specifically, Mastrobuono, Volt and Edwards Electric which hold that regardless of whether New York law or Illinois law apply, the arbitrators correctly decided that they were without authority to award punitive damages in this case.

Although Plaintiff has argued the choice of law provision violates Illinois public policy, this Court will find that there is no public policy in [p. 5] favor of punitive damages in Illinois, and that the public policy of protecting investors has been met in this case by the award of compensatory damages.

In regard to the federal preemption question, although, there is a split of authority in the circuits, again, relying on Mastrobuono and Volt, and perhaps even more importantly, on the Illinois Appellate Court decision in the Yates case, this Court will find that there is no federal preemption.

In regard to the issue on the effect of the uniform submission agreement, this Court is not bound by nor persuaded by Plaintiff's reliance on the Neuberger case, the Illinois – I'm sorry – the New York trial court case which has been cited, and believes that the arbitrator's interpretation of that agreement should stand.

Finally, in regard to the interest and tender issue. Relying on the cases of Yassin, Thomas and Wrobel, and to a lesser extent, Edwards Electric, this Court does not believe that there was a proper tender in this case. And since the award was not paid within thirty days of entry as required under NASD Rules, this Court believes that there should be interest at the rate of nine percent from the date of the award, [p. 6] which I believe is February 5th, 1993.

Accordingly, we need to put in the judgment order, among these findings, if you choose to put these findings in or else you can just say for the reasons stated in open

court, that the petition to confirm in part and vacate in part is granted in part and denied in part.

The motion to dismiss and to confirm the arbitration award without interest is granted as to the first part of the relief requested, and is denied as to the second part of the relief requested therein. And the counter-petition to confirm an arbitration award is granted in part and denied in part. And of course you are going to want to put the language about no just reason to delay enforcement or appeal of this order.

Can you bring me in a typed order perhaps tomorrow, Plaintiff?

MR. CARRIER: Yes. That would be fine.

THE COURT: Anything further?

MR. BOULTON: We don't need a special time, just bring it in?

THE COURT: You can just bring it. And why don't you put in there, I know you put in your order and [p. 7] judgment all costs incurred by Petitioner should be reimbursed. Why don't you say the parties to bear their own costs, unless somebody wants to give me something that says what we're talking about as costs that would about [sic] more appropriate to put in the order.

MR. CARRIER: Well, I have a list of costs incurred for the Plaintiff for the filing of the Petition up to today.

THE COURT: Okay. I think under the circumstances it would be appropriate to have each side bear its own costs.

If you want to, there is some type of – Is there a provision in the statute?

MR. CARRIER: The statute says that it's discretionary, your Honor.

THE COURT: I think it should be each side bear its own costs, unless you can show me under the agreement or something like that, something else other than the Illinois Statute. You're talking about just the Illinois Statute?

MR. CARRIER: The Illinois Arbitration Act says that when you confirm the award, you can grant costs if you believe that under the circumstances in the case it is justified.

[p. 8] We argued in the petition, I mean, in our later briefs that it was justified to a large extent because of all of the delays that were encountered in the case and the repetitive filing of petitions for extension of times to answer by the Respondent.

THE COURT: Okay. I believe that we should just have each side at this point bear their own costs.

Just put that in the order.

MR. CANTWELL: I have just one question, your Honor,

I believe that the access from the date of the NASD – The date the award was received I think was February 16th. I would have to check the date, whatever it was.

THE COURT: I was trying to figure out what the date was.

MR. CARRIER: The rules in the statute both say from the date of the award, Your Honor.

THE COURT: I thought it was the date of the award. It says here – We're talking four days.

The award was entered February 5th, and it says date of service by NASD, February 9th. I'm looking at the award, so . . .

MR. CANTWELL: All right. I think that's the date [p. 9] of receipt that actually controls. And I think that thirty-day language, and I can check it for the Court, says –

THE COURT: Do you have it with you?

MR. CANTWELL: I believe it's in our brief. But in either event, I would just ask – I will certainly show it to counsel, and we will take a look at it. I think it would be calculated from the date that the award is received by the parties, and that may be the thirty-day rule.

MR. CARRIER: Here it is.

MR. CANTWELL: I have it here. It says –

THE COURT: Tell me what you're reading from?

MR. CANTWELL: This is from Section 41-H of the NASD Rules. Let me show counsel.

All monetary awards shall be paid within thirty days of receipt, unless a motion to vacate has been filed with a court of competent jurisdiction.

So it's thirty days of receipt.

MR. CARRIER: Okay. That's the payment. But keep reading.

MR. CANTWELL: well, it says, "Interest shall be assessed at the legal rate –

THE COURT: Try again. Slower.

[p. 10] MR. CANTWELL: "Interest shall be assessed at the legal rate, if any, then prevailing in the state where the award was rendered or at a rate set by the arbitrators."

It doesn't go back and pick up any other date.

Turn the page and see if it continues.

THE COURT: I didn't bring everything out here with me. I will be glad to go back and get it.

MR. CARRIER: In the second sentence of the rules it says, "An award shall bear interest from the date of the award."

MR. CANTWELL: Well, it does say that.

THE COURT: Let's go by the date of the award, and let's call it February 5th, 1993.

MR. CANTWELL: Okay. Your Honor, I want to thank the Court for wading through the mountain of material that was presented here. This was no easy task, and the issues –

THE COURT: Thank the Court and the Court's law clerk.

MR. CANTWELL: Mr. Manus. I have never met Mr. Manus before, I don't believe; but I've talked to him on the phone for scheduling.

[p. 11] Your Honor, I think, however it was done, this Court did a tremendous job.

THE COURT: Good.

MR. CANTWELL: And I think that I applaud the Court's decision.

I do feel strongly about the interest issue, because if you read it the way –

THE COURT: And I'm sure they feel strongly about the punitive damages issue.

MR. CANTWELL: I know. But the important issue and the thing that has really been decided by this Court were the things that the Court expressed today.

THE COURT: Well, thank you, gentlemen. And I look forward to getting your order when you can get it to me.

MR. CARRIER: Right. We will bring it in tomorrow, Judge.

THE COURT: And I'm really sorry about having to move you and everything, but I wanted to get it done.

MR. CANTWELL: Judge, I just did a preliminary injunction hearing at the end of last week, so I know how difficult it can be to get things scheduled, believe me.

Thank you.

[p. 12] MR. BOULTON: Thank you, your Honor.

MR. CARRIER: Thank you, your Honor

(WHICH WERE ALL THE PROCEEDINGS HAD IN THE ABOVE-ENTITLED CAUSE.)

[p. 13] IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS COUNTY DEPARTMENT – CHANCERY DIVISION

I, Diane O. Washington, an Official Court Reporter for the Circuit Court of Cook County, County Department – Chancery Division, do hereby certify that I reported in shorthand the Proceedings had at the hearing in the above-entitled cause; that I thereafter caused the foregoing to be transcribed into typewriting, which I hereby certify to be a true and accurate transcript of the proceedings had before the Honorable DOROTHY KIRIE KINNAIRD, Judge of said court.

/s/ Diane O. Washington
Official Court Reporter

Dated this 17th day
of August, 1994.

IN ARBITRATION BEFORE THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

MARCIA M. ROUBIK, Claimant, v. MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., LARRY H. LOVITSCH and THOMAS R. VALAIKA, Respondents.	)	Claim No. 91-00169

CLAIMANT'S MEMORANDUM IN SUPPORT OF THE AWARD OF PUNITIVE DAMAGES BY ILLINOIS ARBITRATORS

I.

INTRODUCTION

Contrary to stated securities industry policy, contrary to applicable New York choice of law rules, contrary to applicable Illinois regulatory and judicial policy, and contrary to applicable substantive federal law, Respondents take the position that the New York choice of law provision in the Customer Agreement and a single, widely criticized, fifteen-year old, 4-3 New York Appellate opinion[1] prohibits an arbitration panel in Illinois from awarding punitive damages to an Illinois claimant upon claims arising from a series of events between the parties conducted in Illinois. As is fully discussed below, the position Respondents take in this case has been repeatedly

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[1] *Garrity v. Lyle Stuart Inc.*, 40 N.Y.2d 354, 486 NYS2d 831, 353 N.E.2d 793 (1976).

rejected by arbitration panels and by state and federal courts sitting outside of New York and has even, in several instances, been rejected by arbitration panels and federal courts sitting in New York.

II.

THE STATED POLICY OF THE SECURITIES INDUSTRY SUPPORTS THE AWARD OF PUNITIVE DAMAGES IN INDUSTRY-SPONSORED ARBITRATIONS

Section 25(b) of the Security Industry Conference on Arbitration (SICA) Arbitrator's Manual states:

> "The issue of punitive damages may arise with great frequency in arbitrations. *Parties to arbitrations are informed that arbitrators can consider punitive damages as a remedy.* Generally, in court proceedings, punitive damages consist of compensation in excess of actual damages and are awarded as a form of punishment against the wrongdoer. If punitive damages are awarded, the decision of the arbitrator should clearly specify what portion of the award is intended as punitive damages, and the arbitrators should consider referring to the authority upon which they rely." (emphasis added.)[2]

A former arbitration director of the American Stock Exchange, David E. Robbins, has publicly acknowledged

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[2] In apparent recognition that the conduct need not be "malicious" or "willful" to invoke an award of punitive damages, the sentence, "Malicious and willful conduct are usually present in instances when punitive damages are awarded in court proceedings" has been deleted from a previous version of this section.

that opposition to punitive damages awarded in securities arbitration is, at best, "irresponsible":

> "Despite *Garrity*, a responsible brokerage firm defending a matter in New York would be hard-pressed to object to the confirmation of an award for punitive damages.
>
> The Supreme Court in *McMahon* was unanimous in its decision that RICO claims must be arbitrated. It is hard to imagine that if the Supreme Court empowers an arbitration panel to award treble damages in RICO cases it would preclude punitive damages in an appropriate case.
>
> Lastly, since a court or jury could award punitive damages for common law fraud or a breach of fiduciary duty, and since such cases must be arbitrated, prohibiting an arbitration panel from considering such damages would be inequitable and contrary to the goals of arbitration."[3]

Current NASD Rules of Fair Practice prohibit any provision in a Customer Agreement which limits the ability of the arbitrators to make *any* award. NASD Rules of Fair Practice, Section 21(f)(4), provides:

> "No agreement shall include any condition which limits or contradicts the rules of any self-regulatory organization or limits the ability of a party to file any claim in arbitration or limits the ability of the arbitrators to make any award."

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[3] D. Robbins, Practitioner's Guide to Securities Arbitration, 601 (PLI.124-125, 1988).

III.

UNDER THE CIRCUMSTANCES IN THIS CASE, NEW YORK COURTS WOULD APPLY ILLINOIS LAW

In their effort to disenfranchise courts and arbitration panels outside the state of New York by exporting the *Garrity* decision to all states throughout the country, the brokerage industry has, without advising customers of the potential legal impact of a "New York" choice of law upon the arbitration provision, routinely included a New York choice of law provision in their standard form customer agreements.

What Respondents do not recognize is that under New York law, given the circumstances of this case, notwithstanding the New York choice of law provision in the customer agreement, New York courts themselves would refuse to apply New York law to this claim.[4]

In *Business Incentive Co., Inc., v. Sony Corporation of America*, 397 F.Supp. 63, 67 (D.C. S.D.N.Y. 1975), the Court held:

> "In general, courts will ordinarily honor contractual choice of law provisions, as long as the state selected has sufficient contacts with the transaction in question and the application of the state's law would not be contrary to any fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue at bar, and which would be the state of the applicable

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[4] It should be noted that the choice of law provision in the Customer Agreement contains no exclusion for New York conflict of law provisions.

> law in the absence of an effective choice of law by the parties. Restatement 2d, Conflict of Laws, §187. Despite the provision in the parties' Agreement that New York law would apply, it appears that, under the above test, New Jersey law should govern instead. The only contacts with New York are that defendant is a New York corporation and the original 1965 contract provided for performance in the New York metropolitan area. New Jersey, on the other hand, would seem to have a materially greater interest in the application of its law because of the fact that plaintiff is a New Jersey corporation, that the performance of the contract now in issue (executed in 1967 and modified in 1972) contemplated performance exclusively in New Jersey, and, most importantly, that New Jersey has a strong public policy – enunciated both by its courts and its legislature – in favor of protecting the relatively powerless consumer or small businessman from more powerful commercial giants, such as automobile manufacturers, oil companies, and, presumably, electronics manufacturers. See *Henninigsen v. Bloomfield Motors, Inc.*, (1960) 32 N.J. 358, 161 A.2d 69, *Shell Oil Company v. Marinello*, (1973) 63 N.J. 402, 307 A.2d 598. In light of the foregoing, there is no doubt but that New Jersey law should apply, despite the parties' agreement to the contrary."

See also, *Joy v. Heidrick & Struggles*, 403 N.Y.S.2d 613, 93 Misc. 2d 818 (1977). The Court held that where the chosen choice of law state has no substantial relationship to or reasonable basis for the parties or is contrary to the fundamental public policy of the state which has a materially greater interest than the chosen state, the court will disregard the law of the state chosen by the parties to the

agreement. In *Keystone Leasing v. Peoples Protective Life Insurance Co.*, 514 F.Supp. 841 (E.D.N.Y. 1981), the Court held Tennessee law applicable where Tennessee had the most significant contacts with the parties and the transaction. *See also: Duplan Corporation v. W. Davis Hosiery Mills*, 442 F.Supp. 86 (D.C. S.D.N.Y. 1977) (holding a New York choice of law provision invalid and applying North Carolina law); *Helen Triad Financial Establishment v. Trumpane*, 611 F.Supp. 157 (D.C. N.D.N.Y. 1985) (New York courts do not consider themselves bound by a forum selection clause if its application would override policies of the state with materially greater interest in the controversy and must consider which forum has the most significant relationship with the parties in the transactions).

In this case, Respondent Merrill Lynch is a Delaware corporation. It is and was at all relevant times licensed to do business in Illinois; Respondents Lovitsch and Valaika were, at all times relevant to this claim, full-time Illinois residents as were Claimant and Claimant's mother, Mrs. Edna E. Roubik. All Respondents were, as required by applicable Illinois law, licensed by the State of Illinois to sell securities in Illinois. The Customer Agreement was executed in Illinois. The accounts in questions were opened, maintained and had their tax situs at Merrill Lynch's Oakbrook, Illinois office. The acts or failures to act at issue in this claim occurred in Illinois and the adverse financial impact of Respondents' activities incurred in Illinois. Claimant and Claimant's mother have paid and will pay significant amounts of Illinois income tax based upon past transactions in the account and any recovery in this claim. It is the public policy of the State

of Illinois to protect its citizens from unlawful and fraudulent conduct on the part of securities brokers licensed to transact business in the State of Illinois and to protect consumers, generally. See Illinois Securities Law of 1953, S.H.A. Chapter 121 1/2, Section 137.1-137.15[5]; and The Illinois Consumer Fraud and Deceptive Business Practices Act, S.H.A. Chapter 121 1/2, Section 261-262.

In *Meihsuer v. Runyon*, 23 Ill. App. 2d 446, 163 N.E.2d 236 (2d Dist. 1960), the Court made the following statement concerning the purpose of the Illinois Securities Act:

> "The objective of the Illinois Securities Act is to protect innocent persons who may be induced to invest their money in speculative enterprises over which they have little or no control. The Act is paternalistic in character and should be liberally construed to better protect the public

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[5] At Section 137.12, the Act provides:

It shall be a violation of the provisions of this Act for any person:

> F. To engage in any transaction, practice or course of business in connection with the sale or purchase or securities which works or tends to work a fraud or deceit upon the purchaser or seller thereof;
>
> G. To obtain money or property through the sale of securities by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading;
>
> I. To employ any device, scheme or artifice to defraud in connection with the sale or purchase of any security, directly or indirectly.

> from deceit and prevent fraud in the sale of stock, bonds and other securities within the state."

23 Ill. App. 2d 446, 456, 163 N.Y. 2d 236, 241 (2d Dist. 1960).

Most importantly, the arbitration will be held in Illinois, not New York. Clearly, Illinois is the state with the most substantial and most significant interests and contacts with the circumstances of this case and the parties. Under the facts of this case, not even New York courts would apply New York law to the case.

IV.

JUDICIAL AUTHORITY IN ILLINOIS AND OTHER STATES OUTSIDE NEW YORK STRONGLY SUPPORT THE AUTHORITY OF AN ARBITRATION PANEL TO MAKE AN AWARD OF PUNITIVE DAMAGES

There is *no* Illinois decision or statute limiting the authority of arbitration panels sitting in Illinois from awarding punitive damages. Illinois Appellate Court opinions empower arbitrators in Illinois to decide *all* claims within the scope of the contract.

As noted in *Hollister, Inc. v. Abbott Laboratories, Inc.*, 170 Ill. App. 3d 1051, 524 N.E.2d 1035, 120 Ill. Dec. 853, *appeal denied*, 122 Ill. 2d 575, 530 N.E.2d 245, 125 Ill. Dec. 217 (1st Dist. 1988):

> Parties to a contract may agree that any and all disputes ariding out of that contract shall be submitted to arbitration. Therefore, when a dispute under such an agreement is submitted to arbitration, the arbotrator is empowered to

> make an award that will fully settle the dispute. *Wilcox Co. v. Bouranas*, 73 Ill. App. 3d 1046, 1051, 392 N.E.2d 198, 202, 29 Ill. Dec. 641, 645.

An arbitrator in Illinois may utilize the full panoply of remedies available for a given claim to resolve all the disputes. The scope of an arbitrator's power is governed by the arbitration agreement between the parties. *Id.* The *Hollister* court elaborated on the scope of Illinois arbitrator's powers stating,

> When parties agree to submit a dispute to arbitration it is presumed that: (1) the parties intended all matters in dispute be decided; (2) in the absence of an express reservation, the parties agreed that everything, both as to law and fact, which is necessary to the resolution of the dispute is within the authority of the arbitrator and (3) the arbitrator did not exceed his authority. *Wilcox Co. v. Bouranas*, 73 Ill. App. 3d 1046, 1051, 392 N.E.2d 198, 202, 29 Ill. Dec. 641, 645.

By mutual agreement of the customer and Merrill Lynch, "any controversy" is subject to arbitration. Punitive damages to the extent they are found warranted under the facts and applicable substantive law are within the province of the arbitrator's power.

Even if Illinois courts were inclined to follow *Garrity*, the arbitrator's in this matter would be empowered to award punitive damages because the Federal Arbitration Act would preempt application of state law purporting to limit the arbitrator's powers. *See, Howell v. Hoffman*, 154 Ill. Dec. 713, 568 N.E.2d 934 (Ill. App. 3d Dist. 1991) discussed infra p. 14, and discussion infra Section V pp. 12-21.

Where the *Garrity* decision has been specifically considered by state courts outside of New York it has met near unanimous rejection.

Cf, Baker v. Sadick, 162 Cal. App. 3d 618, 208 Cal. Rptr. 676, 683-84 (4th Dist. 1985) where the court affirmed a judgment confirming an arbitration award in a medical malpractice action, finding that the provision for arbitration of "any issue of medical malpractice" authorized the award of punitive damages and noting, "[i]t strains legal imagination to conclude an agreement to substitute arbitration for litigation results *ipso facto* in forbearance of a claim which would support an award of punitive damages." 162 Cal. App. 3d 618, 630, 208 Cal. Rptr. 676, 684 (Cal. 1985); *Regina v. Envirmech,* 80 Md. App. 662, 565 A.2d 693 (Md. App. 1989) where a defendant attempted to avoid the obligation to arbitrate by asserting fraud as an affirmative defense and then suggesting arbitration would be inappropriate because an arbitrator was not empowered to award punitive damages. Rejecting *Garrity* the court stated, "we reject as wholly unfounded the notion that [defendant] can defeat arbitration simply by claiming punitive damages. . . . unless the arbitration agreement precludes it, we see no reason why in an appropriate case, an arbitrator cannot award punitive damages. *citations omitted.* Arbitrators are generally accorded a fair amount of discretion in fashioning remedies and sanctions." 80 Md. App. 662, 565 A.2d 693, 699 (Md. App. 1989); *USX v. West,* 781 S.W.2d 453 (1st Dist. 1989) where the court held that an arbitration provision calling for arbitration of "any controversy" encompassed punitive damages compelling to arbitration a claim for punitive damages where "controversy" relates

to both any cause of action and any claim for damages; *State Farm Fire and Casualty Co. v. Wise*, 150 Ariz. 16, 17, 721 P.2d 674, 675 (2d Div. 1986) where the court found that the failure to expressly exclude punitive damages from uninsured motorist coverage exposed an insurance company to liability for punitive damages in arbitration, because the insured was entitled to recover the same damages under the uninsured provision as would have been available if the uninsured motorist had maintained a policy of liability insurance. 150 Ariz. 16, 721 P.2d 674, 675 (2d Div. 1986).

Additionally, a recent New York Court of Appeals decision cast substantial doubt upon the continue [sic] viability of the *Garrity* opinion in New York itself. In *Singer v. Jeffries & Co.*, 78 N.Y.2d 26, 571 N.Y.S.2d 680 (1991), the New York Court of Appeals unanimously upheld the arbitrability of a dispute between a securities firm and a former employee. In the opinion, the court showed an attitude towards arbitration far more hospitable than that expressed in the *Garrity* opinion. After noting that the Federal Arbitration Act governed the arbitration agreement before it, the Court stated that:

> "Congress adopted the [Arbitration] Act to insure that the courts would rigorously enforce private agreements to arbitrate, and it establishes an 'emphatic' national policy favoring arbitration which is binding on all courts, state and federal. Pursuant to the Arbitration Act, questions of arbitrability must be addressed with a healthy regard for the federal policy . . . and any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. As is the case with any contract, the

> intention of the parties is controlling, but [under the Arbitration Act] those intentions are generously construed as to issues of arbitrability." (571 N.Y.2d 682)

It is an indisputable fact that within the past five years, since the Supreme Court's 1987 *McMahon*[6] decision, that there have been numerous industry-sponsored arbitrations both within and outside of New York wherein punitive damages have been awarded against securities brokers. Exhibit A attached to this Memorandum summarizes 43 securities arbitration awards in which punitive damages have been awarded since June of 1987 through the end of 1990. Also attached as Exhibit B is a copy of the arbitration award in *Trecker v. Merrill Lynch* decided in January, 1990, by an arbitration panel sitting in Milwaukee, Wisconsin. There, in circumstances similar to those in this case, the panel awarded actual damages of $530,000 and punitive damages of $700,000. See also, *Roberts v. Oppenheimer & Co., Inc., Barrett, MKI Securities Corp.*,[7] an NYSE arbitration involving issues of fraud, unsuitability, breach of fiduciary duty and violations of California statutory law, in this case the panel awarded $50,000 in compensatory damages and $2 million in punitive damages on a claim of $250,000.

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[6] *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 167 S.Ct. 232, 96 L.Ed. 2d. 185 (1987).

[7] 21 BNA Securities Reg. NL Rep. 1290 (August 18, 1989).

V.

FEDERAL SUBSTANTIVE LAW BARS THE APPLICATION OF THE GARRITY DECISION TO THE FACTS OF THIS CLAIM

In *Dugal International, Inc. v. Sallmetall,* No 84 Civ 7170 (JMC) (S.D. N.Y. 1986) Judge Cannella refused to follow the holding in *Garrity*. Judge Cannella reasoned that the Federal Arbitration Act rather than state law governs the issue of an arbitrator's authority to award punitive damages because the Federal Arbitration Act creates federal substantive law applicable in both state and federal courts, citing *Southland Corp. v. Keating,* 465 US 1, 104 S.Ct. 852, 79 L.Ed.2d 1 (1984) and *"Garrity* places substantive limits on arbitrability." Slip op at 2-3. Judge Cannella then went on to rule that the sanction of punitive damages would be prohibited in arbitration only if there exists (1) a federal policy prohibiting an arbitrator's award of punitive damages, or (2) an express or implied contractual limitation on the arbitrator's power to make such an award. *Id.* at 4. The court found neither contingency to exist on the facts before it and held that the power to award punitive damages was within an arbitrator's authority. *Id.* at 6. Judge Cannella's reasoning was fully supported by the Supreme Court's subsequent decision in *Perry v. Thomas,* 482 US 483, 107 S.Ct. 2520, 96 L.E.2d 426 (1987) issued a week after its decision in *Shearson/American Express, Inc. v. McMahon.*[8] In *Perry* the Supreme Court ruled that Section 2 of the Federal Arbitration Act created a body of federal substantive law of

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[8] *Supra,* Note 6.

arbitrability even if there is state substantive or procedural policy to the contrary and that this body of federal substantive law is enforceable on both state and federal courts.

Respondents cannot dispute the interstate nature of the buying and selling of publicly listed registered securities on national securities exchanges. Nor that the transactions themselves or any disputes regarding the transactions at issue in this claim involve interstate commerce.

Because of the intrinsically interstate and even international nature of the national securities markets, transactions and disputes involving the buying and selling of publicly-listed and traded securities have consistently been held to involve interstate commerce under the Federal Arbitration Act.

Section 2 of the Federal Arbitration Act, 9 U.S.C. §2, sets forth the statutory criteria utilized to determine the scope of the Act's coverage. It provides:

> A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contact or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Commerce is defined in section 1 as "commerce among the several states or with foreign nations."

In *Willis v. Shearson/American Express, Inc.*, 569 F.Supp. 821 (N.D.N.C. 1983), the Court held that the customer-broker account agreement was a written contract evidencing a transaction in interstate commerce under the Federal Arbitration Act. In *Ferreri v. First Options of Chicago, Inc.*, 623 F.Supp. 427 (D.C. PA 1985), the Court held where the agreement in question contemplated that the partnership would be buying and selling various securities on the Philadelphia Stock Exchange, that the conduct contemplated by the agreement made the agreement a contract "involving commerce" within the meaning of Section 2 of the Federal Arbitration Act.

Illinois courts have recognized that where the agreement between the parties evidences transactions involving interstate commerce, that the Federal Arbitration Act[9] governs to the exclusion of state law. In *Howells v. Hoffman*, 154 Ill. Dec. 713, 568 N.E.2d 934 (Ill. App. 3d Dist. 1991), plaintiff customer sought to bring suit in state court against Merrill Lynch's branch office manager, individually. The branch manager moved to dismiss citing the arbitration provision between the customer and Merrill Lynch. In holding the arbitration provision applicable to the disclosed employee of Merrill Lynch as well as Merrill Lynch itself, the court observed:

> "It is well established that where an arbitration agreement is contained within a contract evidencing a transaction involving commerce, the Federal Arbitration Act ("FAA") (9 U.S.C., §2 (1982) governs to the exclusion of state law. (See *Gelderman, Inc. v. Stathis* (1988), 177 Ill.

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[9] 9 U.S.C. Subsection 2.

App. 3d 414, 532 N.E.2d 366, 126 Ill. Dec. 681.) There is no dispute that the transactions herein involved interstate and not intrastate commerce."

In enacting the Federal Arbitration Act, Congress created national substantive law governing questions of the validity and the enforceability of arbitration agreements under its coverage. *Genesco, Inc. v. T. Kakiuchi & Co., Ltd.*, 815 F.2d 840, 845 (2d Cir. 1987). *See Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984) (the Act creates a body of federal substantive law which governs question of arbitrability); *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983) (federal substantive law created by Act applicable in both state and federal courts). Thus, once it is determined that a dispute is covered by the Act, "federal substantive law as set forth in the Act and federal law governs the scope and interpretation of the agreement. *Cook Chocolate Co. v. Salomon, Inc.*, 684 F.Supp. 1177, 1182 (S.D.N.Y. 1988). *See also Coenen v. R.W. Pressprich & Co.*, 453 F.2d 1209, 1211 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972) (once a dispute is covered by the Act, federal law governs all questions of interpretation, construction, validity, revocability and enforceability).

Since 1984, when the U.S. District Court for the Northern District of Alabama decided *Willoughby Roofing & Supply Co. v. Kajima International, Inc.*, 598 F.Supp. 353 (N.D. Ala. 1984), *aff'd on opinion below*, 776 F.2d 269 (11th Cir. 1985), the overwhelming majority of state and federal courts which have considered the authority of arbitrators to award punitive damages upon a claim or dispute arising from an agreement covered by the Federal Arbitration

Act have held that the arbitrators do have such authority and that any state rule to the contrary is either preempted by the Federal Arbitration Act and/or was not incorporated into the contract by the choice of law provision in the contract.

In *Willoughby,* the District Court was asked to interpret an arbitration agreement that covered "[a]ll claims, disputes, and other matters in question arising out of, or relating to, this Agreement," and incorporated an industry arbitration rule allowing the arbitrator to "grant any remedy or relief." 598 F.Supp. at 355-57. Finding that "strong federal policy requires a liberal construction of arbitration agreements, not a strict one," *id.* at 357, and that it was essential that arbitrators have flexibility in assessing remedies, the Court held that the arbitrator had ample power to include punitive damages in his award.

The Court recognized that two state courts had held that punitive damages may never be awarded in the extra-judicial setting of arbitration.[10] However, the Court in *Willoughby* found that such decisions dealt only with the power of arbitrators under state laws. It found that, when the arbitration provision is included in a contract evidencing a transaction in interstate commerce, the governing law is provided not by state law but by federal law and federal policy under the FAA – even when, as in *Willoughby,* the contract contained the provision that Alabama law generally governed the agreement. *Willoughby,* 598 F.Supp. 359.

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[10] *Garrity v. Lyle Stuart, Inc.,* 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976); *School City of East Chicago v. East Chicago Fed. of Teachers,* 422 N.E.2d 656 (Ind. App. 1981).

The Court also observed:

> "To deny arbitrators the full range of remedial tools generally available under the law would be to hamstring arbitrators and to lessen the value and efficiency of arbitration as an alternative method of dispute resolution . . . This would not sit well with the strong federal policy favoring arbitration."

The Court also relied on the decision of the Supreme Court in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), in which a state statute that conflicted with the Federal Arbitration Act was found to violate the Supremacy Clause and was therefore held void. 465 U.S. at 16. In *Southland*, the Supreme Court looked to the "federal substantive law" to resolve the question of arbitrability. 465 U.S. at 12. Applying federal substantive law to the question of punitive damages, the Court in *Willoughby* noted that such damages are regularly available. It found no public policy bar to prevent arbitrators from considering punitive damages. To the contrary, it found that allowing automatic immunity from punitive damages in arbitration might encourage improper conduct. *Willoughby*, 598 F.Supp. at 363.

Subsequently, the Eleventh Circuit confirmed its opinion in *Willoughby*. In *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378 (11th Cir. 1988), the Court found that punitive damages were available even under an agreement that provided for the laws of the State of New York to govern, and despite New York State's longstanding rule against punitive damages in arbitration. The Court again expressly found that the "choice of law provision in

a contract governed by the Arbitration Act merely designates the substantive law that the arbitrators must apply in determining whether the conduct of the parties warrants an award of punitive damages; it does not deprive the arbitrators of their authority to award punitive damages." *Bonar*, 835 F.2d at 1378. Since the customer agreement "evidenced a transaction in interstate commerce," it was governed by the Federal Arbitration Act and federal law, and punitive damages were available. *Id.* at 1387-88. The Court also rejected the argument that the parties had waived their right to punitive damages by agreement to the application of New York law, since the agreement was too ambiguous on this point to amount to a voluntary and knowing waiver.

The arbitration section (Sec. 13) of the Merrill Lynch customer agreement in this claim states in part, "It is agreed that any controversy between us arising out of your business or this agreement shall be submitted to arbitration . . . "

When construing nearly identical language from another brokerage firm customer agreement to include claims for punitive damages, the Court in *Willis v. Shearson/American Express, Inc.*, 569 F.Supp. 821 (N.D.N.C. 1983), held as follows:

> "The arbitration provision found at paragraph 13 covers the issues raised by the Complaint. The provision is extraordinarily broad as to the matters subject to arbitration. It covers 'any controversy arising out of or relating to. . . . ' the account. (Emphasis added). Furthermore, the provision cannot reasonably be restricted solely to breach of contract questions since by its terms

> it covers any controversy arising out of or relating to the account agreement "or the breach thereof. . . . " In any event, the law is quite clear that "under the Federal Arbitration Act . . . arbitration clauses should be read broadly and arbitration should not be denied in the absence of clear and express exclusions." *Spring Hope Rockwool, Inc. v. Industrial Clan* [sic] *Air, Inc.*, 504 F.Supp. 1385, 1387 (E.D.N.C. 1981); *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, ___ U.S. ___ 103 S.Ct. 927, 941, 74 L.Ed.2d 765, 785 (1983)."

For a recent decision following *Bonar* and *Raytheon*, *see Pyle v. Securities U.S.A., Inc.*, 758 F.Supp. 638 (D.C. Colo. 1991). Here, the Court refused to apply a statute of the arbitration forum state, Colorado, which specifically prohibited an arbitration award of punitive damages. Citing *Bonar* and *Raytheon*, the Court held that the Federal Arbitration Act applied to the contract in question, and in the absence of an express agreement by the parties, that state *arbitration law* should govern, that state law restricting the arbitrator's power to award punitive damages does not apply to an action within the scope of the Federal Arbitration Act.

The Court also held that where, as here, the contract incorporates the NASD Code of Arbitration Procedure, that the contract includes claims for punitive damages:

> "By incorporating into their arbitration agreement the NASD Code of Arbitration Procedure, the parties agreed to arbitrate 'any dispute, claim or controversy arising out of or in connection with the business of any member of the Association.' NASD Code § 1. I conclude that 'any dispute, claim or controversy' includes

> a claim for punitive damages. As the *Raytheon* court stated in determining that a similar contractual provision allowed punitive damages to be awarded, '[s]ince courts are empowered to award punitive damages with respect to certain types of claims [alleged here], the . . . arbitrators would be equally empowered." *Raytheon*, 882 F.2d at 10.

Notwithstanding the above authorities, two recent Second Circuit[11] cases, surprisingly express the opinion that the *Garrity* rule does not conflict with the federal substantive law developed under the Federal Arbitration Act *Fahnestock* and that a New York conflict of law provision means that an arbitration panel sitting in New York has no authority to grant a punitive damage award *Barbier*. Claimant submits that those opinions are clearly a minority view and, for the reasons stated in this memo and those stated by Justice Mahoney in the dissenting opinion in *Fahnestock*, are simply wrongly decided and are in direct conflict with well-developed and well-settled precedents of virtually all state and federal courts outside the State of New York. It is especially relevant that in *Fahnestock* the majority opinion was careful to point out that their ruling has *no effect* in states, such as Illinois, where arbitral punitive damage awards are permitted. The Court stated:

> "Moreover, NYSE arbitrations occur throughout the nation, and our *holding here does not mean* that in those states in which arbitral punitive

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[11] *Fahnestock & Co., Inc. v. Waltman*, 935 F.2d 512 (2d Cir. 1991) and *Barbier v. Shearson Lehman Hutton, Inc.*, 948 F.2d 117 (2d Cir. 1991).

> damages awards are permitted, arbitrators may not appropriately utilize the punitive damages section of the award form." (Emphasis added.)

Claimant further submits that Respondents' reliance upon the 1984 *Pierson* and the 1981 *Baselski*[12] decisions is misplaced. These cases were decided prior to the development of the law discussed above and contain no recognition or discussion of the applicability or effect of New York conflict of law provisions or the Federal Arbitration Act and the policy consideration and substantive federal law contained in the cases decided under the Federal Arbitration Act.

Finally, if under *Aldrich v. Thomson McKinnon Securities, Inc.*, 756 F.2d 243, CCH ¶91,967 (1984-1985 Transfer Binder) (2d Cir. 1985) an award of punitive damages is permissible on pendent state law claims in a case in federal court arising under the federal securities laws and if under *Dean Witter Reynolds, Inc. v. A Lamar Byrd*, 470 US 213, 105 S.Ct. 1238, 84 L.Ed.2d 158, CCH ¶91,953 (1984-1985 Transfer Binder) (1985) arbitrable state law claims pendent to federal securities law claims must be sent to arbitration upon the demand of one of the parties where a predispute arbitration agreement exists, then prohibiting an arbitration panel from considering punitive damages would mean that claimants would have less rights in arbitration than they would have in a state or federal court. Such a result would be clearly inequitable and contrary to the goals of arbitration.

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[12] *Pierson v. Dean Witter Reynolds, Inc.*, 742 F.2d 834 (7th Cir. 1984); *Baselski v. Paine Webber Jackson & Curtis, Inc.*, 514 F.Supp. 535 (N.D.Ill. 1981).

VI.

REGULATORY AND JUDICIAL POLICY CONSIDERATIONS STRONGLY SUPPORT THE USE OF PUNITIVE DAMAGES IN SECURITIES ARBITRATIONS

By seeking to preclude the application of punitive damages to the circumstances of this and other similar cases, Respondents here seek to place themselves in a unique status which is not enjoyed by any other business or professional person in this country. Case law authority for the award of punitive damages involving defective products, medical malpractice, attorney malpractice, druggist malpractice, accountant malpractice and other persons enjoying a professional/fiduciary relationship with their client are extensive and need not be recited in detail. Were Respondents' position to be adopted, Respondents would be in the unique position of being immunized under any set of circumstances no matter how fraudulent, flagrant or abusive their actions might be from ever having to be faced with the threat of a significant award of punitive damages. Claimant submits that in an industry which is involved in the sensitive fiduciary task of giving financial advice and investing other peoples' money on a commission basis, it is especially important to utilize and maintain the deterrent effect of substantial punitive damages.

In a recent U.S. Supreme Court opinion[13], which upheld the constitutionality of punitive damages, the Court held as follows:

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[13] *Pacific Mutual Life Insurance Company v. Haslip*, 111 S.Ct. 1032, 113 L.Ed.2d 1 (Sup.Ct. 1991).

> "Imposing exemplary damages on the corporation when its agent commits intentional fraud creates a strong incentive for vigilance by those in a position 'to guard substantially against the evil to be prevented.' *Louis Pizitz Dry Goods Co. v. Yeldell*, 274 U.S. 112, 116, 47 S.Ct. 509, 510, 71 L.Ed. 952 (1927). If an insurer were liable for such damages only upon proof that it was at fault independently, it would have an incentive to minimize oversight of its agents. Imposing liabilities without independent fault deter fraud more than a less stringent rule. It therefore rationally advances the State's goal. . . . "

As one industry commentator has observed, "In the final analysis, securities arbitration without the possibility of punitive damages being awarded in egregious cases, would be no more effective in discouraging grossly fraudulent conduct than would be a grand larceny auto theft statute that limited punishment upon conviction to divestiture of the stolen car."[14] See also *Raytheon Co. v. Automated Business Systems, Inc.*, 882 F.2d 6 (1st Cir. 1989), where the Court held:

> "Like them, we agree that punitive damages can serve as an effective deterrent to malicious or fraudulent conduct. Where such conduct could give rise to punitive damages if proved to a court, there is no compelling reason to prohibit a party which proves the same conduct to a panel of arbitrators from recovering the same damages. Certainly, the fact that the parties agreed to resolve their dispute through an expedited and less formal procedure does not mean

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[14] Goldberg, *Fraudulent [Broker]-Dealer Practices*, sec.6.5 (1978).

> that they should be required to surrender a legitimate claim to damages. Parties that do wish arbitration provisions to exclude punitive damages claims are free to draft agreements that do so explicitly. In this case, no such exclusion from the general language of the arbitration clause exists. Accordingly, we conclude that the district court correctly ruled that the arbitrators were authorized to award punitive damages against Raytheon."

Miley v. Oppenheimer & Co., 637 F.2d 318, 330 (5th Cir. 1981), was one of the first appellate cases upholding a jury verdict of punitive damages against a securities firm.[15] There the Court stated:

> "Most courts in the past have seen fit, when they find the broker-dealer's hand in the till, to simply request removal of the offending appendage. And when the till is empty, and the broker-dealer's fingerprints are all that remain where the money once lay, all the courts do is to require the crook to replace the booty. If ever there was a situation where crime pays it is in such circumstances; . . . No wonder one commentator saw fit to term the average recovery in churning cases as creating for the broker-dealer a 'low risk larceny'.
>
> . . . . [T]he only sure way of deterring such conduct in the future is to take the profit away from the wrongdoers and slap on an additional amount as punitive damages; . . . " (637 F.2d at 331-32).

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[15] *See also: Davis v. Merrill Lynch*, 906 F.2d 1206 (C.A. 8th Cir. 1990), upholding a jury award of $2,000,000 in punitive damages against Respondent Merrill Lynch.

The U.S. Supreme Court's decisions in *Shearson American Express, Inc. v. McMahon*,[16] 482 US 220, 107 S.Ct. 232, 233, 96 L.Ed.2d 185 (1987); and *Rodriquez de Quijas v. Shearson American Express*, 490 U.S. 477, 109 S.Ct. 1917, 104 L.Ed.2d 526 (1989); in practical effect, vitiated approximately 34 years of federal precedent which had held that the federal securities laws claims were not arbitrable and established that most disputes in the securities industries will be resolved in arbitration. Within this context, prohibiting an arbitration panel from considering punitive damages would mean that claimants would have less rights in arbitration than they would have in a federal or state court and would be contrary to the Supreme Court's directive that these matters should be resolved by arbitration rather than the judicial system. It also runs contrary to the strong federal policy enunciated by the Federal Arbitration Act and the cases decided under the FAA, which strongly direct the resolution through arbitration of *all* disputes within the scope of the agreement, including those involving punitive damages.

Clearly as a matter of equity, claimants in securities arbitration cases must be entitled to all of the same rights and remedies in arbitration as in a court of law. To rule otherwise would be contrary to announced securities industry policy, the holdings of the U.S. Supreme Court and various federal appellate courts and state courts, recognizing and enforcing the policy considerations of the Federal Arbitration Act, which favors the arbitration

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[16] The *McMahon* opinion held that RICO claims may be arbitrated. If established, a RICO claim mandates treble damages.

of all claims and controversies within the scope of the agreement.

VII.

CONCLUSION

Because of the stated policies of the securities industry favoring arbitration for the resolution of all disputes, including those related to punitive damages, the inapplicability of the New York choice of law provision of the Customer Agreement, the judicial authority in Illinois and other states supporting the authority of an arbitration panel to make an award of punitive damages, the federal substantive law which bars the application of the *Garrity* decision to the facts of this claim, and the recognized judicial policy considerations supporting the use of punitive damages in securities arbitrations, Claimant respectfully requests a prehearing ruling that the panel has full authority to hear Claimant's claim of punitive damages and if after hearing such claim, punitive damages are found to be justified on the merits, that the panel has the authority to make an appropriate award as is justified by the circumstances of the case.

In the *Willoughby* opinion, *supra*, the Court observed that because a plaintiff who has agreed to arbitration, is not deemed to have automatically waived his right to be heard on the issue of punitive damages, the practical effect of a bar on the arbitrability of punitive damages would be unsatisfactory in that under these circumstances where, as here, tort and breach of contract claims are mixed and punitive damages are sought, to follow the *Garrity* decision would require two trials, i.e., one before

the arbitrators and then a separate judicial trial on essentially the same facts, to resolve the claim for punitive damages.

The *Willoughby* Court made reference to *Janmore Leasing, Inc. v. Econo-Car International, Inc.*, 475 F.Supp. 1282, 1291 (E.D.N.Y. 1979), where claims for punitive damage were concededly inarbitrable. The court ruled that a separate judicial trial would be had on the non-arbitratable issues following arbitration of plaintiff's other claims. *See also Davis v. Chevy Chase, Chase Financial Ltd.*, 667 F.2d 160, 165 (D.C. Cir. 1981).

Accordingly, in the alternative, if it is the panel's determination that the panel does not have the necessary authority to make an award of punitive damages, Claimant requests that at the conclusion of this arbitration that, pursuant to Section 16 of the Code of Arbitration Procedure, that the panel dismiss, without prejudice the claim for punitive damages as non-arbitratable and with respect to that portion of the claim, the parties be referred to the remedies provided by applicable law.

Dated: January 16, 1991.

Respectfully submitted,

MARCIA M. ROUBIK

By: /s/ Paul D. Carrier
Paul D. Carrier
Attorney for Claimant

Paul D. Carrier
Fishman & Merrick, P.C.
30 North LaSalle Street
Suite 3500
Chicago, Illinois 60602
(312) 726-1224

CERTIFICATE OF SERVICE

The undersigned attorney certifies that a copy of CLAIMANT'S MEMORANDUM IN SUPPORT OF THE AWARD OF PUNITIVE DAMAGES BY ILLINOIS ARBITRATORS was served upon the Respondents in this matter by causing said Response to be hand-delivered to: Peter A. Cantwell, Esq., Cantwell and Cantwell, 30 North LaSalle Street, Suite 2424, Chicago, Illinois 60602; and that he has caused an original and three copies of this document to be filed with the Director of Arbitration for the National Association of Securities Dealers, Inc. by delivering a copy of this document to: The Director of Arbitration, National Association of Securities Dealers, Inc., 10 S. LaSalle St., 20th Floor, Chicago, Illinois 60603, Attn: William B. Kimme, Esq., this 16th day of January, 1992.

/s/ Paul D. Carrier
Paul D. Carrier
Attorney for Claimant

PUNITIVE DAMAGES AWARDED IN SECURITIES ARBITRATIONS
POST McMAHON JUNE 1987 - 1990

Case	Broker/Dealer Respondent	Customer Claimant	Forum	Decision	State	Compensatory	Punitive	% Puni /Comp
1	Prudential Bache	Forrester	NASD	9/1/88	FL	$ 50,000	$ 100,000	200.00%
2	Prudential Bache	Bowers	AAA	12/23/88	FL	$ 40,243	$ 20,368	50.61%
3	Prudential Bache	Collins	NYSE	2/23/89	CA	$ 54,550	$ 25,000	45.83%
4	Prudential Bache	Teitelbaum	AAA	4/4/89	CA	$ 108,497	$ 10,000	9.22%
5	Prudential Bache	Collier	NASD	7/19/89	OH	$ 220,753	$ 50,000	22.65%
6	Prudential Bache	Cosner	AAA	7/26/89	FL	$ 930,469	$1,100,000	118.22%
7	Prudential Bache	Crossland	NYSE	11/14/89	NY	$ 838	$ 838	100.00%
8	Prudential Bache	Greene	AAA	11/21/89	FL	$ 200,000	$ 200,000	100.00%
9	Prudential Bache	Mariana	NYSE	2/8/90	TX	$ 700,000	$ 250,000	35.71%
10	Dean Witter Reynolds	Cothron	AAA	12/10/87	FL	$ 66,600	$ 66,600	100.00%
11	Dean Witter Reynolds	Mark	AAA	7/29/88	FL	$ 394,629	$1,973,146	500.00%
12	Dean Witter Reynolds	Hutcheson	AAA	8/12/88	FL	$ 70,820	$ 575,000	811.92%
13	Dean Witter Reynolds	Szuts	AAA	1/31/90	FL	$ 198,242	$ 250,000	126.11%
14	Dean Witter Reynolds	Salisbury	AAA	5/5/90	FL	$ 51,000	$ 42,000	82.35%
15	Dean Witter Reynolds	Schmidt	AAA	6/13/90	FL	$ 15,065	$ 25,000	165.95%
16	Shearson	Winship	AAA	7/1/88	GA	$ 175,000	$ 100,000	57.14%
17	Shearson	Sint	NASD	1/31/89	CA	$ 179,037	$ 555,000	309.99%
18	Shearson	Peterson	NASD	9/14/89	AZ	$ 249,254	$1,000,000	401.20%
19	Shearson	Cox	NASD	1/25/90	OK	$ 213,865	$ 213,865	100.00%
20	Merrill Lynch	Diaz-Barriga	NASD	4/15/88	FL	$ 142,093	$ 421,062	296.33%
21	Merrill Lynch	Trecker	NYSE	1/27/90	WI	$ 530,000	$ 700,000	132.08%
22	Merrill Lynch	Crist	NYSE	2/17/90	WI	$ 6,240	$ 6,500	104.17%
23	Paine Webber	Meyer	NASD	4/10/89	GA	$ 244,972	$ 500,000	204.10%
24	Paine Webber	Fong	PSE	7/21/89	CA	$ 403,000	$ 150,000	37.22%
25	Kidder Peabody	Platt	NYSE	5/23/88	NY	$ 716,092	$ 250,000	34.91%
26	Kidder Peabody	Choi	ASE	6/1/90	NY	$ 150,293	$ 2,800	1.86%
27	Anchor National	Troffer	NASD	6/7/90	CA	$ 70,000	$ 30,000	42.86%
28	Bay City Securities	Berry	NASD	11/20/89	GA	$ 6,495	$ 2,500	38.49%
29	Bear Stearns	Falcone	NYSE	2/12/90	FL	$ 148,790	$ 125,000	84.01%
30	Black and Company	Almand	NASD	8/1/90	OR	$ 65,037	$ 65,000	99.94%
31	Blinder Robinson	Kaiser	NASD	3/8/90	MO	$ 40,000	$ 75,000	187.50%
32	Broadchild Securities	Shevrin	NASD	5/19/89	FL	$ 15,598	$ 31,196	200.00%
33	Dreyfus SVC Corp.	Kent	AAA	3/19/90	NY	$ 16,827	$ 50,000	297.15%
34	F.D. Roberts Securities	Sutton	NASD	3/12/90	GA	$ 131,632	$ 250,000	189.92%
35	First Jersey	Shaefer	NASD	8/18/89	FL	$ 15,985	$ 3,500	21.90%
36	Gruntal	Welles	NYSE	10/19/89	NY	$ 28,088	$ 10,000	35.60%
37	Interstate Securities	Willis	AAA	8/16/89	FL	$ 31,055	$ 93,166	300.00%
38	Morgan Keegan	Eunice	NYSE	11/10/89	GA	$ 227,284	$ 50,000	22.00%
39	Profile Inv	Weber	NASD	3/16/90	FL	$ 18,337	$ 100,000	545.33%
40	Rauscher Pierce	Charavay	NYSE	10/31/89	TX	$ 280,000	$ 50,000	17.86%
41	Raymond James	Ellis	NASD	1/24/90	FL	$ 26,650	$ 10,000	37.52%
42	Smith Barney	Anonymous	MSRB	8/3/90	NY	$ 57,111	$ 50,000	87.55%
43	Stuart James	Lopriore	NASD	12/14/90	NC	$ 273,000	$ 50,000	18.32%

EXHIBIT A

EXHIBIT B

New York Stock Exchange **NYSE**
In the Matter of Arbitration Between

Case:

HELEN TRECKER
V
MERRILL LYNCH PIERCE FENNER & SMITH, INC. AND DONALD J. MILLER

Date Filed:	First Scheduled:	Decided:
4/13/88	5/25/89	1/27/90

Case Summary:

Customer against member firm and registered representative for: 1. violation of Section 10(b) of the Securities Exchange Act of 1934; 2. violation of the Wisconsin Uniform Securities Law; 3. breach of contract; 4 common law breach of Fudiciary duty; 5. common law negligence; 6. common law misrepresentation; 7. common law fraud; and 8. unjust enrichment. Customer alleges excessive and unauthorized trading, churning, failure to adequately supervise registered representative according to firm policy, New York Stock Exchange Rules or NASD rules. Customer also alleges unsuitable investments in speculative stocks and options.

Sessions:
Twenty (20) Sessions

Claim Date

Claim	$1,775,000	CC 3rd Pty	
Punitive	$2,250,000	Punitive	
Atty Fees	yes	Atty Fees	
Deposit	$1,000	Deposit	

Award Date

Award	$530,000	CC 3rd Pty	
Punitive	$700,000	Punitive	
Atty Fees		Atty Fees	
Costs		Costs	

Decision: The undersigned arbitrators have decided and determined in full and final settlement of all claims between the parties that:

SEE ATTACHED DECISION

Remarks:

Arbitrators D = Dissents

Stanley Michelstetter, III _____
Signature

George R. Fleischli _____
Signature

Ralph M. Sharafinski _____
Signature

Milwaukee Wisconsin 1/27/90

BEFORE THE NEW YORK STOCK EXCHANGE

In the Matter of the Arbitration of a Dispute Between HELEN B. TRECKER and MERRILL, LYNCH, PIERCE, FENNER & SMITH, INC., and DONALD J. MILLER	DECISION

We, the undersigned, being the arbitrators selected to hear and determine a matter in controversy between the above-named Claimant and Respondents set forth in a submission to arbitration signed by the parties on or about May 10, 1989.

And having heard and considered the proofs of the parties, have decided and determined that Claimant should be, and hereby is, awarded the sum of $530,000 damages, together with $700,000 punitive damages as specified on page 2 of this award (which page is incorporated by reference).

In addition the total costs which are payable to the New York Stock Exchange, Inc. are hereby assessed to Respondents.

The Repondents shall pay Claimant the total sum of $1,230,000 together with the costs assessed herein.

Dated at Milwaukee, Wisconsin this 27th day of January, 1990.

/s/ Stanley H. Michelstetter II
Stanley H. Michelstetter II,
Chairman

/s/ George R. Fleischli
George R. Fleischli,
Arbitrator

/s/ Ralph M. Sharafinski
Ralph M. Sharafinski,
Arbitrator

In addition to findings based upon churning, unsuitability and other civil causes of action, we find that under the facts of this case there existed "special circumstances" creating a fiduciary relationship between Donald Miller, Merrill Lynch on the one hand and the Claimant on the other in that this account constituted a *de facto* discretionary account and Donald J. Miller repeatedly represented to Claimant throughout the relevant period to the effect that he would take care of her interests when he clearly knew she would totally rely upon him. Donald Miller wantonly and willfully disregarded the interests of Claimant in this matter.

Merrill Lynch's supervisors knew, or so clearly should have known that we are holding them to know, of said fiduciary relationship from the outset and wantonly participated in the breach of the duties owed in this case including, but not limited to, the breach of fiduciary duty.

We find the following amount is necessary to punish and deter the wantonly wrongful conduct found herein: $700,000.

IN ARBITRATION BEFORE
THE NATIONAL ASSOCIATION OF SECURITIES
DEALERS, INC.

In Re: the Matter of	)	
	)	
MARCIA ROUBIK,	)	
	)	
Claimant,	)	
	)	Arbitration
v.	)	No. 91-00169
	)	
MERRILL LYNCH, PIERCE,	)	
FENNER & SMITH, INC.,	)	
LARRY H. LOVITSCH, and	)	
THOMAS R. VALAIKA	)	
	)	
Respondents,	)	
	)	

MEMORANDUM OF LAW ON IMPROPRIETY OF PUNITIVE DAMAGES IN ARBITRATION PROCEEDINGS

NOW COME the Respondents, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., LARRY H. LOVITSCH and THOMAS R. VALAIKA, by and through one of their attorneys, and in support of their contention that an award of punitive damages in these arbitration proceedings would be improper upon application of Illinois law, state as follows:

INTRODUCTION

In 1985, Edna and Marcia Roubik, mother and daughter respectively, opened a non-discretionary margin account with Merrill Lynch. Marcia Roubik was named in the account as joint tenant with right of survivorship, apparently as an estate planning measure because Marcia

Roubik had no involvement with the account while her mother was alive. Both Marcia and Edna Roubik signed a contract with Merrill Lynch entitled "Customer Agreement". In pertinent part, Paragraph 13 of that agreement stated as follows:

> Except to the extent that controversies involving claims arising under the Federal securities laws may be litigated,[1] it is agreed that any controversy between us arising out of your business or this agreement shall be submitted to arbitration conducted under the provisions of the Constitution and Rules of the Board of Governors of the New York Stock Exchange, Inc. or pursuant to the Code of Arbitration Procedure of the National Association of Securities Dealers, Inc. as the undersigned may elect.

In addition, Paragraph 17 states as follows:

> This Agreement and its enforcement shall be governed by the laws of the State of New York . . .

Both the Illinois Appellate Court and the Seventh Circuit Court of Appeals have interpreted nearly identical language in brokerage customer agreements to mean that all claims, whether contract or tort, made by the customer against the brokerage are controlled by New York law. *Mell v. Goodbody & Company*, 10 Ill. App. 3d 809, 295 N.E.2d 97, 99 (1st Dist. 1973) (usury claim in tort); *Pierson v. Dean Witter Reynolds, Inc.*, 742 F.2d 334 (7th Cir. 1984) (tortuous [sic] claims of violation of Rule 10b-5, breach of

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[1] The federal securities claims presented in this proceeding are arbitrable. *Shearson/American Express, Inc. v. McMahon*, 107 S.Ct. 2332 (1987).

fiduciary duty, negligence and fraud; District Court reversed for failure to follow New York law).[2]

As background, under New York law punitive damages awards are not permitted in arbitration proceedings. *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976). In *Garrity*, the New York Court of Appeals, the state's highest court, vacated an award of punitive damages granted by an arbitration panel on ground that an arbitrator has no power to award punitive damages, even if agreed upon by the parties. 40 N.Y.2d at at [sic] 355-56. Chief Justice Breitel wrote as follows:

> Punitive damages is a sanction reserved to the State, a public policy of such magnitude as to call for judicial intrusion to prevent its contravention. Since enforcement of an award of punitive damages as a purely private remedy would violate strong public policy, an arbitrator's award which imposes punitive damages should be vacated.

Id. at 356. *Garrity* remains the law of New York. *Belco Petroleum Corp. v. AIG Oil Rig, Inc.*, 164 A.D.2d 583, 565 N.Y.S.2d 776 (1st Dept. 1991); *Diker v. Cathray Construction Corp.*, 156 A.D.2d 657, 552 N.Y.S.2d 37 (2nd Dept. 1990). While to the knowledge of Respondents no Illinois court has dealt specifically with the holding of *Garrity*, some

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[2] The clauses in *Mell* and *Pierson* were substantially identical to the clause in the Roubik agreement. The clause in *Mell* read as follows: "This agreement and its enforcement and performance . . . shall be governed by the laws of the State of New York . . . " 295 N.E.2d at 98. The clause in *Pierson* read as follows: "This Agreement and its enforcement shall be governed by the laws of the State of New York . . . " 742 F.2d at 336.

insight is gained from the case of *Kelso-Barnett Co. v. Zeus Development Co.*, 107 Ill. App. 3d 34, 437 N.E.2d 26, 62 Ill. Dec. 789 (2nd Dist. 1982). In the case, a Plaintiff contested compelled arbitration of its contract claim in part because its claim for exemplary damages on ground of fraudulent inducement could not be granted in an arbitral forum, citing *Garrity*. 437 N.E.2d at 29. The Illinois Appellate Court for the Second District compelled arbitration without comment on the exemplary damages issue. This Memorandum will demonstrate that Illinois choice of law principles command application of *Garrity* to bar punitive damages in this arbitration.

ARGUMENT

I. ILLINOIS CHOICE OF LAW RULES DIRECT THAT NEW YORK LAW BE APPLIED TO THE ISSUES PRESENTED IN THIS CASE.

Generally, in Illinois the law applicable to a contract is that which the parties intended. When that intent is expressed, it should be followed. *Hofeld v. Nationwide Life Insurance Company*, 59 Ill. 2d 522, 322 N.E.2d 454 (1975). Illinois courts have long allowed parties to substitute the laws of another place or country, and will enforce the substitution of law where it is not dangerous, inconvenient, immoral, nor contrary to the public policy of the local government. *Sarnoff v. American Home Products, Corp.*, 798 F.2d 1075 (7th Cir. 1986); *citing McAllister v. Smith*, 17 Ill. 328, 333 (1856). The public policy considerations must be strong and of a fundamental nature to justify overriding the chosen law of the parties. *Potomac Leasing Company v. Chuck's Pub, Inc.*, 156 Ill. App. 3d 755,

509 N.E.2d 751, 109 Ill. Dec. 90 (2nd Dist. 1987). In fact, a court should not refuse to apply the law of a foreign place, however unlike its own, unless it is contrary to pure morals and abstract justice, or unless the enforcement would be of evil example and harmful to its people. *Id., quoting, Champagnie v. W.E. O'Neil Construction Company,* 77 Ill. App. 3d 136, 395 N.E.2d 990, 32 Ill. Dec. 609 (1979).

A. Illinois Public Policy is Completely in Accord with the Ruling in *Garrity,* Because Illinois is Hostile to Punitive Damages and Requires Approval by a Judicial Officer of the State Before Such "Penal" Damages are Allowed.

Not only is New York's rule on punitive damages in arbitration not in conflict with Illinois policy, it is actually parallel. Illinois strongly disfavors punitive damages. A recent commentary by the Illinois Supreme Court from 1990 is most demonstrative:

> Punitive, or exemplary, damages are not awarded as compensation, but serve instead to punish the offender and to deter that party and others from committing similar acts of wrongdoing in the future. [Citations omitted]. Because of their penal nature, punitive damages are not favored in the law. [citations omitted]. Appropriately enough, the initial decision whether punitive damages may be imposed in a particular case in this State is a matter normally reserved to the trial judge.

Loitz v. Remington Arms Company, 138 Ill. 2d 404, 563 N.E.2d 397, 401, 150 Ill. Dec. 510, 514 (1990). The *Loitz*

court reversed an award of punitive damages against a manufacturer. In so doing, the Illinois Supreme Court noted with obvious approval that the Illinois legislature has recently abolished or sharply curtailed the availability of punitive damages in cases of malpractice or common-law negligence, the latter being a claim made in this arbitration (*Ill. Rev. Stat.* (1987), ch. 110, par. 2-1115, 2-604.1). *Loitz*, 150 Ill. Dec. at 516.

It is also important to note from the above-stated quote from *Loitz* that, like New York, Illinois withholds the availability of punitive damages unless the use of the punitive remedy is approved by a *judicial* officer of the State. *See also, Hammond v. North American Asbestos Corp.*, 97 Ill. 2d 195, 454 N.E.2d 210, 73 Ill. Dec. 350, 359 (1983). The rationales of this requirement are easily seen in the Illinois Supreme Court's hostile comparison of punitive damages with criminal fines in a case in which the court refused to allow punitive damages under the Illinois "Survival Act", *Ill. Rev. Stat.*, Ch. 3, para. 339 (1971). *Mattyasovszky v. West Towns Bus Co.*, 61 Ill. 2d 31, 330 N.E.2d 509 (1975). The Illinois Supreme Court stated as follows:

> The objectives of an award of punitive damages are the same as those which motivate the criminal law – punishment and deterrence. Yet in a criminal case the conduct which gives rise to the imposition of punishment must be clearly defined. That is not so when the question is whether the conduct of the defendant can be characterized as either negligence or as willful and wanton conduct. The fine that is imposed upon the defendant in a criminal case goes to the State. But in a civil case the exaction taken

> from the defendant, under the label of exemplary damages, becomes a windfall for the plaintiff. The maximum and minimum amounts of fine imposed by way of punishment and deterrence in a criminal case are fixed by statute. In the civil case, however, the jury is left at large to take from the defendant and deliver to the plaintiff such amount as it sees fit.

330 N.E.2d at 512. Thus, barring punitive damages in this arbitration can hardly be said to violate a stated public policy of the State of Illinois. To the contrary, New York's rule, if anything, compliments the policy of Illinois.

B. Illinois Law Upholds the Parties' Choice of Law Provision Because of the "Substantial Contracts" Between this Controversy and the State of New York.

The parties' choice of law clause in their contract more than meets Illinois' second recognized limitation to an express choice of law provision, that being a requirement that there be some relationship between the chosen forum and the parties or the transaction. *Potomac Leasing Company v. Chuck's Pub, Inc.*, 156 Ill. App. 3d 755, 509 N.E.2d 751, 109 Ill. Dec. 90 (2nd Dist. 1987), *citing, inter alia, Mell v. Goodbody & Company*, 10 Ill. App. 3d 809, 295 N.E.2d 97 (1st Dist. 1973). The purpose of this requirement is to preclude parties from arbitrarily selecting the laws of some jurisdiction which has no relation to the matter in controversy. *Id., citing* 16 Am.Jur.2d, *Conflicts of Law*, §78, at p.126 (1979).

In *Mell v. Goodbody & Co., supra*, the Illinois Appellate Court upheld a choice of law clause in a fact pattern

nearly identical to this proceeding. In *Mell,* brokerage margin account customers brought a class action against their broker seeking to recover interest and penalties pursuant to the Illinois Interest Act as it applied to stock margin accounts with a debit balance of less than $5,000.00. Defendant, Goodbody & Company, was a limited partnership organized under the laws of the State of New York and dealing in the security brokerage business. It was a member of all principal security exchanges, with its principal office located in New York and branch offices located in Chicago. The plaintiff customers each signed a form agreement establishing the margin account relationship. That agreement provided in part that all accounts opened by plaintiffs would be governed by the laws of the State of New York. 295 N.E.2d at 98.

Defendant Goodbody & Company moved for summary judgment based upon five separate and independent grounds, the primary reason being that the transactions were governed by the law of the State of New York, under which law the transactions were plainly not usurious. The trial judge found for defendant on all five grounds and allowed its motion for summary judgment. Upon appeal, the Illinois Appellate Court held that the trial court correctly awarded summary judgment because the transactions in question were governed by the law of the State of New York. 295 N.E.2d at 99. The court found that the case's numerous and significant contacts with New York satisfied the reasonable relationship test applicable to choice of law situations, including the facts that the principal place of business of the brokerage was in New York, the major exchanges upon which the large majority of the transactions in issue were

performed were in New York, the brokerage's central billing and margin calls production facilities were in New York, and many of the notices and documents received by the customer were produced in New York. This conclusion was reached in spite of the fact that there were also very substantial relationships with Illinois in those brokerage agreements, and despite the contention that giving effect to New York law, and particularly to the New York usury statute, which permits an interest higher than that allowed in Illinois, would arguably violate Illinois public policy. *Id.* at 99-100.

Mell controls the case at bar, especially since, and unlike in *Mell*, New York's *Garrity* decision is *in conformance with* Illinois courts' stated hostility to punitive damage awards. The Statement of Claim admits that Merrill Lynch's principal place of business is in New York, New York, and that Lovitsch and Valaika engaged in purported wrongdoing as agents of Merrill Lynch. Moreover, the brokerage arrangements between the parties in this arbitration is virtually identical to the arrangements between the parties in *Mell*.

Illinois public policy is not offended by applying New York law and there is a reasonable relationship between the chosen forum and the transactions in question. The only possible conclusion is that Illinois courts would apply New York law in this case.

II. THE FEDERAL COURTS OF ILLINOIS AND NEW YORK RECOGNIZE AND APPLY *GARRITY* TO BAR PUNITIVE DAMAGES IN ARBITRATION.

Illinois federal courts have long supported the conclusion of the New York courts. In *Baselski v. PaineWebber, Jackson & Curtis, Inc.*, 514 F.Supp. 535 (N.D.Ill. 1981), investors brought an action alleging violation of federal securities laws, various breaches of common law fiduciary duties and the tort of misrepresentation. Defendants moved to compel arbitration pursuant to an agreement by the parties to arbitrate claims arising out of their broker-customer relationship. The plaintiffs contended that the arbitration clause at issue was unconscionable and that enforcement of the clause would result in a forfeiture of their right to pursue punitive damages. *Id.* at 537-38, 542-43.

The District Court for the Northern District of Illinois, however, was not persuaded that the parties' agreement to arbitrate their state claims was unconscionable or that submission of these claims to arbitration would result in an unknowing forfeiture of the plaintiff's right to pursue punitive damages. The court held that the parties agreed in their customer agreement that their contractual relationship would be governed by the law of the State of New York and that plaintiffs thereby contractually waived their right to punitive damages. *Id.* at 543.

Four years after *Baselski*, the Seventh Circuit Court of Appeals reached the same conclusions in *Pierson v. Dean Witter Reynolds, Inc.*, 742 F.2d 334 (7th Cir. 1984). In *Pierson*, as in the present case, the customer agreement called for arbitration. As demonstrated earlier in this brief, the

Pierson court recognized that the parties' contract contained a clause applying New York law, and that the clause made New York law applicable to all the plaintiffs' claims. The Seventh Circuit then recognized that under New York law punitive dar[illegible] awards in arbitration are barred, citing *Garrity*. The Seventh Circuit went on to rule that the contractual agreement both to arbitrate and apply New York law operated as a waiver of any claim for punitive damages. The Court of Appeals explained as follows:

> Perhaps the Piersons did not fully appreciate all the plain wording in the arbitration clause, which includeo losing the right to a jury trial in the arbitrable issues and losing the possibility of obtaining punitive damages, but we cannot reform the clause to the Piersons' satisfaction.

Pierson, 742 F.2d at 338.

The Seventh Circuit later stated:

> Perhaps the Piersons did not realize that punitive damages are not permitted in arbitration under New York law (we cannot tell from the record before us) but they were aware that the law of New York was to apply exclusively. Similarly, though *perhaps* not contemplated by the Piersons when they signed the contract, loss of a right to a jury trial is a necessary and fairly obvious consequence of an agreement to arbitrate. The Piersons cannot use their failure to inquiry about the ramifications of that clause to avoid the consequences of the agreed-to arbitration.

Id. at 339.

In the recent cases of *Fahnestock & Company, Inc. v. Waltman*, 935 F.2d 512 (2nd Cir. 1991), and *Barbier v. Shearson, Lehman, Hutton, Inc.*, Docket No. 91-7070 (2nd Cir. 1991), the federal Court of Appeals for the Second Circuit, which court sits in New York City, reaffirmed its application of *Garrity* in cases where the parties' agreement contains a choice of law provision directing that disputes arising under the contract be governed by New York law. In *Barbier*, the Second Circuit noted that:

> The application of *Garrity* here is not in derogation of the parties' agreement but rather in accordance with that agreement. "Where . . . the parties have agreed to abide by [New York law], enforcing [that law] according to the terms of the agreement is fully consistent with the goals of the Federal Arbitration Act," even if the result is that punitive damages are prohibited where in the absence of the choice of law provision, they would be permitted. *Volt Information Sciences*, 489 U.S. at 479. It is apparent from the inclusion of the choice of law provision that the parties intended to be bound by *Garrity* and 'as with any other contract, the parties intentions control.' *Mitsubishi Motors Corp. v. Soler Chrysler Plymouth, Inc.*, 473 U.S. 614, 626 (1985).

Barbier, Docket No. 91-7070 (2nd Cir. 1991).

III. THE AVAILABILITY OF PUNITIVE DAMAGES MUST BE DECIDED UNDER THE STATE LAW SELECTED BY THE PARTIES BECAUSE, AS A MATTER OF LAW, THE ISSUE IS NOT WITHIN THE SCOPE OF THE FEDERAL ARBITRATION ACT.

The federal courts have already considered, and rejected, the applicability of the Federal Arbitration Act to prevent enforcement of a choice of law clause in the parties' contract. *Fahnestock & Company, Inc. v. Waltman*, 935 F.2d 512 (2nd Cir. 1991). In *Fahnestock*, the petitioner stock brokerage firm appealed from a judgment entered in the United States District Court for the Southern District of New York confirming only the compensatory damages portion of an arbitration award in favor of its former employee, Waltman. Waltman cross-appealed from the same judgment insofar as it vacated the punitive damages portion of the arbitration award. *Id.* at 513. Waltman argued that the agreement between the parties in that case fell within the coverage of the Federal Arbitration Act, 9 *U.S.C.* §1 *et seq.* (1988), which did not include restrictions on an award of punitive damages. *Id.* at 517.

The Second Circuit Court of Appeals disagreed, and affirmed the *vacatur* of punitive damages, stating:

> While it is true that in enacting the F.A.A., "Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements," *Southland Corp. v. Keating*, 465 U.S. 1, 16, 104 Supreme Court 852, 861, 79 L.Ed.2d 1 (1984), it also is true that "[t]he F.A.A. contains no express preemptive provision, nor does it reflect a congressional intent to occupy

> the entire field of arbitration," *Volt Info. Sciences v. Board of Trustees of the Leland Stanford Junior University*, 489 U.S. 468, 477, 109 S.Ct. 1248, 1254, 103 L.Ed.2d 488 (1989). Accordingly, state law may be applied in arbitration matters, subject to preemption only to the extent that it actually conflicts with federal law. *Id.* . . . What the F.A.A. requires is that parties comply with their agreements to arbitrate. " '[A]rbitration as a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.' " *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 648, 106 S.Ct. 415, 418, 89 L.Ed.2d 648 (1986).

Id.

Nor can Claimant invoke the F.A.A. because the Customer Agreement contains no specific reference to punitive damages. As stated by the *Fahnestock* court, "state law relating to the propriety of a punitive damages award by arbitrators in the absence of an agreement on the subject is not preempted by any federal substantive law bearing on the subject". 935 F.2d at 518. Thus, "the propriety of an award of punitive damages for the conduct in question . . . [is a] question [ ] of state law' " *Id., quoting, Browning Ferris Industries v. Kelco Disposal, Inc.*, 492 U.S. 257, 278 (1989). *See also, Barbier v. Shearson Lehman Brothers*, Docket No. 91-7070, slip op. at 14 (2nd Cir. 1991) (1991 Lexis 26411). Simply put, the application of New York law to bar punitive damages is neither altered nor preempted by the Federal Arbitration Act.

CONCLUSION

Twist and turn as she may, the Claimant simply cannot be allowed to evade the provisions of her contract to arbitrate and to apply New York law, especially when she herself is making claim under that very contract in her Statement of Claim. As demonstrated above, in the past, Illinois state courts have applied New York law in situations where the parties have contractually selected New York law to govern their relationship, and New York's Garrity rule does not contravene the public policy of Illinois.

It is therefore beyond dispute that, even viewed from the standpoint of applying Illinois law, New York law is the rule of decision, and that the punitive damages are not available to Claimant in this proceeding.

Respectfully submitted,

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., LARRY H. LOVITSCH AND THOMAS R. VALAIKA

By: /s/ Peter A. Cantwell
One of Their Attorneys

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IN ARBITRATION BEFORE THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

MARCIA M. ROUBIK, Claimant, v. MERRITT LYNCH, PIERCE, FENNER & SMITH, INC., LARRY H. LOVITSCH and THOMAS R. VALAIKA, Respondents.	)	Claim No. 91-00169

CLAIMANT'S REPLY MEMORANDUM IN SUPPORT OF THE AWARD OF PUNITIVE DAMAGES BY ILLINOIS ARBITRATORS

CASE LAW CITED BY RESPONDENTS IS INAPPLICABLE TO THE FACTS AND CIRCUMSTANCES OF THIS CASE.

Respondents desperately attempt to justify their position by misinterpreting the meaning of various cases. Illustrative of this attempt is Respondents' reference to *Yates v. Doctors Associates, Inc.*, 140 Ill. Dec. 359, 549 N.E.2d 1010 Ill. App. (5th Dist. 1990). Not only does the case not deal with the issue of preemption of the New York *Garrity*[1] rule by the Federal Arbitration Act but the language of the court's opinion cited by respondent is clearly *dicta* and is identified as such by the court at the outset with the following language:

---

[1] *Garrity v. Lyle Stuart, Inc.*, 40 N.Y. 2d 354, 46 N.Y.S. 2d 831, 353 N.E.2d 793 (1976).

> "Even if defendants' preemption argument had not been waived, we would nevertheless be compelled to conclude . . . "

Prior to this statement, the court held that the waiver of the preemption issue was dispositive of the preemption issue. Even were the quoted language a holding, it does not reach the issue involved in this case i.e. whether the New York *Garrity* rule is preempted by the Federal Arbitration Act. Rather, *Yates v. Doctors Associates, Inc.* presented the same question as that raised in *Volt* – whether the FAA procedural rules preempt non-conflicting state arbitration rules to which the parties agreed to be bound.

Respondent grossly misreads and misapplies the U.S. Supreme Court's decision in *Volt Information Sciences v. Board of Trustees of the Leland Stanford Jr. University*, 489 U.S. 468 (1989). Applying common theories of contract construction, the *Volt* Court found that the parties had expressly intended to be bound by the "law of the place where the Project is located" – California. Pursuant to California statutes governing arbitration procedures, the parties were entitled to move to stay arbitration, even though the Federal Arbitration Act did not provide for such a stay. The Court held that the application of the California arbitration procedural provision was not preempted by the Federal Arbitration Act in the face of the parties agreement to be bound by the California laws.

That the Federal Arbitration Act did not preempt the application of California statutes in *Volt* is not to say that there is no instance in which the Federal Arbitration Act will be viewed as having a preemptive effect on conflicting state arbitration laws. In fact, *Volt* does not even address this question inasmuch as the Court reasoned

there was no conflict between the application of the Federal Arbitration Act and the California state arbitration laws. As the Supreme Court explained,

> " . . . even when Congress has not completely displaced state regulation in an area, state law may nonetheless be pre-empted to the extent that it actually conflicts with federal law – that is, to the extent that it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' " *citation omitted.*

Considering the purpose of the Federal Arbitration Act – "the enforcement . . . of privately negotiated arbitration agreements", and the application of the California arbitration statue [sic] providing for a stay of arbitration, the Court expressly found that the application of the state statute would not undermine the goals and policies of the Federal Arbitration Act. 109 S.Ct. at 1255. Absent a conflict between the federal and state statutes, it is not possible for the Federal act to preempt the state statute. Hence, the Court concluded that the Federal Arbitration Act did not preempt the California arbitration statute. At most, *Volt* stands for the proposition that where there is no conflict between the Federal Arbitration Act and the relevant state arbitration laws, and where the parties have agreed to be bound by specific state arbitration laws, the Court will enforce the parties' agreement and will not allow the Federal Arbitration Act to interfere with the arbitration procedures.

The *Volt* opinion is frequently miscited, here belatedly, by brokerage firm defendants for the proposition

that New York choice of law provision prohibits an arbitration panel from awarding punitive damages otherwise permitted under the Federal Arbitration Act. The *Volt* court, however, did not speak to the strength of the Federal Arbitration Act in the face of an actual conflict between the federal Act and the state laws under question. The *Volt* court, also, did not address whether the Federal Arbitration Act would supersede the application of state laws governing arbitration, where substantive law produces a different result under the Federal Arbitration Act versus substantive state law. Thus, on the question of the availability of punitive damages in securities arbitration, the *Volt* decision is not dispositive.

RESPONDENTS HAVE EXPRESSLY AGREED TO ARBITRATE THE PUNITIVE DAMAGE CLAIM.

The narrow reach of *Volt* is crucial in considering an arbitrator's power to award punitive damages. In a recent Ninth Circuit opinion, *Todd Shipyards Corp. v. Cunard Line, Ltd.* 943 F.2d 1056 (9th Cir. 1991), the court evaluated the propriety of awarding punitive damages in arbitration in the face of the parties' agreement containing a New York choice of law provision. The court rejected the defendant's argument that *Volt* precludes operation of the Federal Arbitration Act as matter of law. Finding *Volt* "inapposite", the *Todd* court explained:

> "The Supreme Court did not say a state choice of law provision that does not expressly encompass state arbitration rules, does so by *operation of law*. The court merely said that it would not disturb a state court's *factual* determination that the parties to the contract in *Volt* intended, to

> invoke California arbitration rules. *Id.* 109 S.Ct. at 1255.
>
> "In this case it is clear that federal rules, rather than New York state rules apply. The Supreme Court has said time and again that issues of arbitrability in cases subject to the Act are governed by federal law. *citations omitted.* The Supreme Court did not reconsider these cases in *Volt* and the rule that federal law governs applies in this case. *See, Raytheon Co. v. Automated Business Systems, Inc.*, 882 F.2d 6, 11 n. 5 (1st Cir. 1989)."

943 F.2d at 1062-63 (emphasis added).

The *Todd* court rejected Cunard's argument that even under federal law the arbitrator is not authorized to issue punitive damages. Referring to the parties' express incorporation of the Commercial Rules of the American Arbitration Association, the court found that the parties necessarily incorporated the portion of those rules that permits the arbitrator to "grant any remedy or relief which the Arbitrator deems just and equitable within the scope of the agreement of the parties." The *Todd* court held that, a broad arbitration agreement coupled with the incorporation of rules giving an Arbitrator a wide array of remedies, supports equipping arbitrators with the power to award punitive damages.

Likewise, in the present matter, the parties agreed to arbitrate the issue of punitive damages. Their agreement incorporates the NYSE and NASD rules. The NYSE and NASD rules, like the Commercial American Arbitration Act rules, provide that an arbitrator may grant broad remedies and relief which the arbitrator deems just and

equitable (See Claimant's Initial Memorandum of January 16, 1992, p.2). As such, the arbitrators are authorized to make a punitive damage award where the facts warrant such an award. The question of whether the facts warrant a punitive damage award is decided on the basis of application of substantive state law. It is undisputed that both New York and Illinois law permit an award of punitive damages upon proof of willful misconduct such as that described in the Statement of Claim.

Furthermore, the contract at issue in this claim provides:

> " . . . it is agreed that *any controversy* between us arising out of your business or this agreement shall be submitted to arbitration under the provisions of the Constitution and Rules of the Board of Directors of the New York Stock Exchange, Inc., or pursuant to the Code of Arbitration Procedure of the National Association of Securities Dealers, Inc . . . "[2].(emphasis added)

The only precedent cited by either party as to the legal meaning of this provision in the agreement is cited by Claimant at pages 18 and 19 of Claimant's January 16, 1992 Memorandum, i.e., *Willis v. Shearson American Express, Inc.*, 569 F. Supp. 821 (N.D.N.C. 1983) and *Pyle v. Securities U.S.A., Inc.*, 758 F. Supp. 638 (D.C. Colorado 1991). These cases hold that the language of the contract and the meaning of the term "any controversy", as a matter of law includes a claim for punitive damages.

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[2] See Claimant's Exhibit B attached to the Statement of Claim, Customer Agreement, page 3, paragraph 13. (emphasis added)

Such is the significance of incorporating by reference the NASD Code of Arbitration procedure.

Even if there were any remaining doubts as to the meaning and intent of the parties it was definitively resolved on April 3, 1991 when, with full access to the advice of sophisticated legal counsel, each respondent executed a Submission Agreement for this arbitration which provides at paragraph 1:

> "The undersigned parties *hereby submit* the present matter in controversy, *as set forth in the attached Statement of Claim,* answers, cross claims and all related counterclaims and/or third party claims which may be asserted, to arbitration in accordance with the constitution, by laws, rules, regulations and/or *Code of Arbitration Procedure* of the sponsoring organization." (emphasis added)

Not even these Respondents can dispute that the Statement of Claim filed on January 15, 1991 in this matter contained a clear statement of a claim for punitive damages and that by executing the Submission Agreement the parties expressly agreed to submit the claim of punitive damages as well as all other claims stated in the Statement of Claim, to this arbitration panel for decision under the NASD Code of Arbitration Procedure.

Section 1 of the NASD Code of Arbitration Procedure provides:

> "Sec. 1. This Code of Arbitration Procedure is prescribed and adopted pursuant to Article VII, Section 1(a)(3) of the By-Laws of the National Association of Securities Dealers, Inc., (the Association) for the arbitration of *any dispute,*

> *claim, or controversy* arising out of or in connection with the business of any member of the Association, with the exception of disputes involving the insurance business of any member which is also an insurance company:" (emphasis added)

The *Pyle* opinion, cited above and in Claimant's January 16, 1992 Memorandum at page 19, stands for the proposition that as a matter of law the above section *includes* claims for punitive damages.

RESPONDENTS' DUE PROCESS ARGUMENT IS TOTALLY WITHOUT MERIT.

For at least the last 25 years, corporate defendants have been arguing unsuccessfully that the award of punitive damages violates their right to due process. The courts have routinely rejected this argument. The issue recently received the attention of the U.S. Supreme Court and *Pacific Mutual Life Insurance Company v. Haslip*, 499 U.S. ___, 111 S.Ct. 1032, 113 L.Ed. 2d 1 (S.Ct. 1991). In upholding an award of $1,000,000 in punitive damages, imposed under the theory of respondeat superior, where plaintiff's out-of-pocket loss was less than $4,000, the court found no violation of due process where the jury had been instructed that in exercising their discretion with respect to an award of punitive damages that they, "must take into consideration the character and degree of the wrong as shown by the evidence and the necessity of preventing similar wrong." Do Respondents really mean to contend that only the judicial/jury system wherein the approved due process standard as is cited above is capable of protecting respondent's due process rights? Can

the largest member of the U.S. brokerage industry now contend that its own industry-sponsored arbitration process is not capable of protecting its rights to due process when the brokerage industry has been publicly arguing for years that all customer-broker disputes must be subject to arbitration rather than a judicial/jury system? The U.S. Supreme Court has answered these questions in *Shearson American Express v. McMahon*, 482 U.S. 107, S.Ct. 232, 233, 96 L.Ed 2d 185 (1987); and *Rodriquez De Quijas v. Shearson American Express*, 490 U.S. 477, 109 S.Ct. 1917, 104 L.Ed 2d 526 (1989). In those two cases, the court expressly rejected the outdated judicial hostility towards arbitration and effectively mandated that all customer-brokerage claims, including RICO claims, with their treble damage feature be arbitrated. More recently, the 9th Circuit Court of Appeals had occasion to review the due process argument in an arbitration context and expressly rejected the argument. *See Todd Shipyards v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991). In *Todd*, there was an arbitration award of $11.4 million, which included a $1 million award of punitive damages. With respect to the punitive damage award, Defendant unsuccessfully advanced the same due process argument as Respondents seek to assert here. The court held:

> "Cunard's assertion that arbitrators are not bound by rules of evidence, procedure or substantive law, applies to all arbitrator decisions. Because of the lack of formality, parties enter into arbitration by contract, rather than through a statutory scheme imposed involuntarily. Cunard cannot agree to arbitrate "all disputes" and then assert that an award made pursuant to

> that agreement, unless it is faulty for some reason, denies due process because it is not sufficiently reliable. Cunard had every opportunity to present evidence, to argue the merits of its position, and to challenge the arbitrator's award in court. Having taken advantage of this process, into which it entered voluntarily, Cunard cannot now argue that its due process was denied."

943 F.2d 1063-64.

CONCLUSION

For the reasons given in Claimant's January 16, 1992, Memorandum on the issue of punitive damages and those cited above in this Memorandum, Claimant respectfully submits that this arbitration panel has full authority under the Federal Arbitration Act[3] and the case law interpreting that Act to award punitive damages on this claim. Secondarily, were the Panel to conclude otherwise, as discussed in Claimant's January 16, 1992, Memorandum at Pages 25 and 26, the correct procedure is to bifurcate, without prejudice, the claim and pursuant to Section 16 of the Code of Arbitration Procedure, as to the punitive

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[3] *See* Exhibit A attached hereto, NASD sponsored arbitration award in *Gage v. Cigna Securities, Inc.*, NASD Case No. 90-01371, decided March 10, 1992, awarding $1.8 million of actual damages and $3.5 million of punitive damages. At Page 3, ¶2, the Panel states "This Panel bases its authority to award punitive damages on the Federal Arbitration Act and the case law interpreting that Act."

damage claim, refer the parties to the remedies provided by applicable law through the judicial system.

Dated: April 16, 1992.

Respectfully submitted,

MARCIA M. ROUBIK

By: /s/ Paul D. Carrier
Paul D. Carrier
One of her
Attorneys

OF COUNSEL:

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Chicago, Illinois 60602
(312) 726-1224

PDCPLEAD/PDC.002

CERTIFICATE OF SERVICE

The undersigned attorney certifies that the original of this CLAIMANT'S REPLY MEMORANDUM IN SUPPORT OF THE AWARD OF PUNITIVE DAMAGES BY ILLINOIS ARBITRATORS was served upon the Respondents in this matter by causing said document to be hand-delivered to: Peter A. Cantwell, Esq., Cantwell and Cantwell, 30 North LaSalle Street, Suite 2424, Chicago, Illinois 60602; and that he has caused a copy of this document to be filed with the Director of Arbitration for the National Association of Securities Dealers, Inc. by mailing, first class, postage prepaid, a copy of the this

document to: The Director of Arbitration, National Association of Securities Dealers, Inc., 10 S. LaSalle St., 20th Floor, Chicago, Illinois 60603, Attn: William B. Kimme, this 16th day of April, 1992.

/s/ Paul D. Carrier
Paul D. Carrier
Attorney for Claimant

EXHIBIT A

Arbitration

National Association of
Securities Dealers, Inc
One East Broward Boulevard
Suite 1000
Ft. Lauderdale, Florida 33301
(305) 522-7391

N.A.S.D. AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS

In the Matter of the Arbitration Between	
Name of Claimant(s)	Case No. 90-01371
George H. Gage George Gage Individual Retirement Account	
Name of Respondent(s)	
Cigna Securities, Inc. Dennis G. Stearns Jan E. Mercedes Mercedes, Stearns & Associates Cigna Individual Financial Services Co.	

REPRESENTATION

For Claimants, George H. Gage ("Gage") and George H. Gage Individual Retirement Account ("Gage IRA"): Guy M. Burns, Esq. of Johnson, Blakely, Pope, et al.

For Respondents, Cigna Secutiries, Inc. ("Cigna"), Cigna Individual Financial Services Co., ("CIFS") Mercedes, Stearns & Associates ("MSA") Dennis G. Stearns ("Stearns") and Jan Mercedes ("Mercedes"): Douglas J. Titus, Jr., Esq. and Frederick S. Schrils, Esq. of Holland & Knight. Mercedes and Stearns were at times also represented by Michael C. Addison of Dykema Gossett.

CASE INFORMATION

Statement of Claim filed: May 14, 1990. Claimants' Submission Agreement signed: May 11, 1990.

Respondents' Statement of Answer filed: July 26, 1990. Respondents' submission agreements signed by Stearns and Mercedes individually and on behalf of MSA on July 19, 1990, and by James E. Anderson on behalf of Cigna on July 25, 1990 and by David C. Kopp on behalf of CIFS on July 23, 1990.

HEARING INFORMATION

Pre-hearing conferences were held with the Panel on November 8, 1990 and May 8, 1991 in Tampa, Florida, lasting 2 sessions. The pre-hearing conference on November 8, 1990 was conducted by telephone conference call and the one on May 8, 1991 was in person. Hearings lasting 57 sessions were conducted in Tampa, Florida on November 14, 15 and 16, 1990; March 20, 21 and 22, 1991; April 10, 11 and 12, 1991; April 24, 25 and 26, 1991; May 9 and 10, 1991; July 10, 11 and 12, 1991; September 4, 5 and 6, 1991; October 2, 3 and 4, 1991; October 17 and 18, 1991; and December 9 and 11, 1991.

CASE SUMMARY

Claimants alleged that Respondents, through misrepresentations, induced Claimants into purchasing limited partnership interests which were unsuitable in light of Claimants' investment objectives, and that Respondents were liable for breach of fiduciary duty; negligence and gross negligence; negligent supervision; common law fraud; breach of contract; violations of the anti-fraud provisions of the Florida and federal securities laws; violation of investment advisor registration provisions of Florida and federal securities laws; and civil remedies for criminal practices under Florida law.

Respondents denied all allegations of wrongdoing and alleged that Claimants' investment objectives were tax benefits, growth and income; that Claimant Gage stated that he had no need of liquidity; and that Claimant Gage was suitable for the investments and was a sophisticated investor; and that Claimant Gage was informed of the risks involved. Respondents asserted affirmative defenses of: assumption of risk; setoff; waiver; estoppel; independent intervening acts; statutes of limitations; and failure to state a claim for punitive damages.

RELIEF REQUESTED

Claimants requested damages in the approximate amount of $1,754,800.00 for their total principal contributions plus interest, costs, treble, and other punitive damages, and a determination that Claiment is entitled to recover his attorney's fees.

Respondents requested dismissal of the Statement of Claim, with prejudice.

OTHER ISSUES CONSIDERED & DECIDED

1. Claimants also sought to make claims for life insurance products sold to the Claimants by Respondent Stearns and to call witnesses to testify in that regard. Respondents requested that Claimants be prohibited from presenting any evidence regarding or relating in any way to insurance matters. These issues were disposed of by a Preliminary Order of this Panel on March 20, 1991 which granted Respondents' Motion to Exclude Insurance Issues.

2. The parties have agreed that the Award in this matter may be executed in counterpart copies or that a handwritten, signed Award may be entered. In either case, the parties have agreed to receive conformed copies of the Award while the original(s) remain on file with the NASD.

AWARD

After considering the pleadings, the testimony and the evidence presented at the hearing, the undersigned arbitrators have decided in full and final resolution of the issues submitted for determination as follows:

1. Respondents Cigna, CIFS, MSA, Stearns and Mercedes are found liable, jointly and severally, for violation of the anti-fraud provisions of the Florida securities laws, negligence, gross negligence, breach of fiduciary duties and common law fraud and shall pay to Claimants Gage

and the Gage IRA the amount of $1,800,000.00 inclusive of interest. Respondents Cigna and CIFS are also found liable, jointly and severally, for negligent supervision, which constitutes an additional basis of their aforesaid joint and several liability for the aforesaid sum.

2. Respondents Cigna and CIFS are also found liable and shall pay to Claimants Gage and Gage IRA the further amount of $3,500,000.00 as punitive damages. This Panel hereby awards such punitive damages pursuant to its determination that Respondents Cigna and CIFS violated Florida laws relating to breach of fiduciary duty, negligence, gross negligence, negligent supervision and common law fraud. This Panel finds that the actions and inactions of Respondents Cigna and CIFS constituted a willful, wanton and methodical scheme to deceive Claimants. This Panel bases its authority to award punitive damages on the Federal Arbitration Act and the case law interpreting that Act.

3. Claimants' request for treble damages, costs and attorneys' fees are denied.

4. No allocation is being made between the two Claimants with respect to this award, since Gage is essentially the sole party in interest with respect to Gage IRA. Further, both Claimants and Respondents in most respects treated the two Claimants as identical.

OTHER COSTS

The parties shall each bear all other costs and expenses incurred by them in connection with this proceeding.

FORUM FEES

Pursuant to Section 43(c) of the Code of Arbitration Procedure, the Panel has assessed forum fees in the amount of $59,000.00 (2 pre-hearing conferences x $1,000.00 plus 57 sessions x 1,000.00 per session). Claimants are hereby assessed $23,250.00 for which the NASD shall retain the $23,250.00 previously deposited in full satisfaction thereof. Respondents Cigna and CIFS are hereby assessed $35,750.00, jointly and severally, for which the NASD shall retain the $31,500.00 previously deposited by Respondent Cigna in partial satisfaction thereof, leaving a balance due and owing in the amount of $4,250.00.

Fees are payable to the National Association of Securities Dealers, Inc.

Concurring Arbitrators' Signatures

Name	Public/Industry
/s/ William R. Paul	Public
/s/ James A. Cormack	Public
/s/ Regar Mickler	Industry

Date of Decision: March 10, 1992

IN ARBITRATION BEFORE THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

In Re: the Matter of MARCIA ROUBIK, Claimant, v. MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., LARRY H. LOVITSCH, and THOMAS R. VALAIKA Respondents.	)	Arbitration No. 91-00169

RESPONDENTS' REPLY BRIEF ON THE IMPROPRIETY OF PUNITIVE DAMAGES IN ARBITRATION PROCEEDINGS.

NOW COMES the Respondents, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., LARRY H. LOVITSCH and THOMAS R. VALAIKA, by and through one of their attorneys, and in reply to the Memorandum submitted by Claimant in support of an award of punitive damages in these arbitration proceedings, state as follows:

1. CLAIMANT'S CITED CASE LAW DEMONSTRATES THAT UNDER ILLINOIS LAW PUNITIVE DAMAGES ARE AN EXERCISE OF THE STATE'S EXCLUSIVE POLICE POWER WHICH IS OUTSIDE OF THE POWERS OF THE ARBITRATION PANEL.

While Claimant correctly quotes Illinois cases[1] which grant the arbitrator "everything, both as to law and fact,

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[1] *Respondents maintain their position that the law of New York, not Illinois, controls the issue of punitive damages in this arbitration proceeding.*

which is necessary to resolve the dispute" this very language demonstrates the weakness of Claimant's argument, because punitive damages simply are not "necessary" to resolve the dispute between Marcia Roubik and the Respondents. The dispute revolves around Roubik's demand for compensation for alleged losses purportedly caused by the Respondents. Under Illinois law, however, punitive damages are not compensation to the Claimant, but an exercise of the police powers of the government of the State of Illinois. As stated by the Illinois Appellate Court in *Hazelwood v. Illinois Central Gulf R.R.*, 114 Ill. App. 3d 703, 712, 450 N.E.2d 1199, 1207, 71 Ill. Dec. 320, 328 (4th Dist. 1983) (court's emphasis):

> Today, the nature of punitive damages is clearly singular – it is *punishment for the defendant* (*Kelsay* [*v. Motorola, Inc.*, 74 Ill. 2d 172, 384 N.E.2d 353, 23 Ill. Dec. 320 (1978)]). That punishment is designed in turn to promote three purposes: (1) to act as retribution against the defendant; (2) to deter the defendant from committing similar wrongs in the future; and (3) to deter others from similar conduct.

Because punitive damages have no role in compensating the Plaintiff upon her claim, the employment of punitive damages is not "necessary" to resolve the controversy before this panel. Additionally, Claimant cannot be heard to skirt the effect of the law by claiming that the punitive damages issue itself represents a "dispute" or "controversy". Illinois does not recognize a cause of action for punitive damages alone. *Tonchen v. All-Steel Equipment Co.*, 13 Ill. App. 3d 454, 300 N.E.2d 616 (2nd Dist. 1973), *citing, Freese v. Tripp*, 70 Ill. 496 (1873).

II. THE FEDERAL ARBITRATION ACT DOES NOT PREEMPT NEW YORK LAW BECAUSE NEW YORK'S RULE AGAINST PUNITIVE DAMAGES IS NOT IN CONFLICT WITH THE ACT.

The Claimant's assertion of the Federal Arbitration Act as her vehicle to obtain punitive damages misstates federal law because it ignores the latest ruling of the United States Supreme Court concerning the Federal Arbitration Act, a ruling which completely rebuts the Claimant's contention that the FAA broadly preempts state law. In *Volt Information Services, Inc. v. Board of Trustees of the Leland Stanford, Jr. University*, 489 U.S. 468, 109 S.Ct. 1248, 103 L.Ed.2d 488 (1989), the plaintiff filed a demand for arbitration of its claim against the defendant college arising from a construction contract. Importantly, as part of the contract, the parties agreed that the law of the locale in which the property was located, which was California, would control. The college responded by filing a California state court lawsuit against the plaintiff and two other parties. The two additional parties were joined on a third-party claim for indemnity, but the college had no arbitration agreement with the new parties. When the plaintiff moved to compel arbitration of its claim, the college moved for entry of a stay of arbitration based upon a California statute which allowed such a stay pending resolution of third-party litigation. The California trial court granted the stay, and the California appellate courts upheld it. The plaintiff appealed to the United States Supreme Court on ground that the FAA preempted application of the California statute.

The Supreme Court held that the FAA did not preempt the California statute. The Court stated as follows:

> The [FAA] was designed to "overrule the judiciary's long standing refusal to enforce agreements to arbitrate," . . . and place such agreements " 'upon the same footing as other contracts.' " [Section] 4 of the FAA does not confer a right to compel arbitration of any dispute at any time; it confers only the right to obtain an order directing that "arbitration proceed *in the manner provided for in [the parties'] agreement.*"

109 S.Ct. at 1253 (Court's emphasis).

Crucially, the Supreme Court specifically rejected use of the FAA as a sword to preempt application of state law to which the parties specifically agreed:

> Where, as here, the parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that arbitration is stayed where the [FAA] would otherwise permit it to go forward. By permitting the courts to "rigorously enforce" such agreements according to their terms, . . . we give effect to the contractual rights and expectations of the parties without doing violence to the policies behind the FAA.

Id. at 1255-56. Thus, applying the teaching of *Volt*, the state law agreed to by the parties is effective unless it actually conflicts with federal law.

A. Illinois Law Applies Volt to Allow Operation of State Law Choice of Law Clauses.

Illinois courts have already applied *Volt* to reject the preemption argument presented by the Claimant. In *Yates*

v. Doctor's Associates, Inc., 193 Ill. App. 3d 431, 549 N.E.2d 1010, 140 Ill. Dec. 359 (5th Dist. 1990), a dispute erupted between franchisors and franchisees concerning a series of submarine sandwich shop franchises. The franchisees-plaintiffs filed suit in Illinois state court against the franchisor-defendants. After a complex procedural history, including removal to federal court and a return to state court, the defendants presented a motion to compel arbitration pursuant to arbitration clauses in the franchise agreements. The trial court denied the motion. The defendants appealed, arguing that the Federal Arbitration Act both preempted state law and compelled arbitration.

The Illinois Appellate Court rejected FAA preemption, stating in relevant part as follows:

> Even if the defendants' preemption argument had not been waived, we would nevertheless be compelled to conclude that the Federal Arbitration Act (9 U.S.C. §1 *et seq.*) does not control.[2] In advancing their analysis, defendants overlook that their franchise agreements contain a choice-of-law provision. Section 12 of the agreements expressly provides that the agreements "shall be governed by and construed in accordance with the laws of the State of Connecticut * * * ." There is nothing in the record before us to suggest that this provision was not intended to be fully applicable to the arbitration clause in the franchise agreements. As a matter of basic contract interpretation, we must therefore conclude that the parties had agreed that arbitration, like any

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[2] *The Appellate Court found waiver because the FAA had not been asserted before the trial court.*

other issue under the franchise agreements, was to be governed by the law of Connecticut.

Where, as here, the parties have agreed to arbitrate in accordance with State law, the Federal Arbitration Act (9 U.S.C. §1 *et seq.*) does not apply, even though the transaction involves interstate commerce. [citing *Volt*]. This is so except where the applicable State law would prevent the arbitration agreements negotiated between the parties from being enforced according to their terms. See, *e.g., Southland Corp. v. Keating* (1984) 465 U.S. 1, 104 S.Ct. 852, 79 L.Ed.2d 1 (finding preempted a State statute which rendered agreements to arbitrate certain franchise claims unenforceable); *Perry v. Thomas* 1987, 482 U.S. 483, 107 S.Ct. 2520, 96 L.Ed.2d 426 (finding preempted a State statute which rendered unenforceable private agreements to arbitrate certain wage collection claims).

Such a result is implicit in the purposes of the Federal Arbitration Act (9 U.S.C. §1 *et seq.*) which, as the U.S. Supreme Court has recently held, "was designed 'to overrule the judiciary's long-standing refusal to enforce agreements to arbitrate.' [citation] and to place such agreements 'upon the same footing as other contracts.' [citation.]" (*Volt Information Services, Inc. v. Board of Trustees of the Leland Stanford, Jr. University* (1989), 489 U.S. *[474]*, 109 S.Ct. 1248, 103 L.Ed.2d 488, 499.) The Act "simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." 489 U.S. at *[478]*, 109 S.Ct. at 1255, 103 L.Ed.2d at 500.

549 N.E.2d at 1015. The Appellate Court affirmed denial of the motion to compel on ground that the defendants'

acts of filing separate suits against the plaintiffs constituted a waiver of arbitration under applicable state law.

The Claimant's cited case, *Howells v. Hoffman*, 209 Ill. App. 3d 1004, 568 N.E. 2d 934, 154 Ill. Dec. 713 (3rd Dist. 1991), is not controlling precedent because the case involved whether arbitration could be compelled, not what law would control the arbitration. The court ordered arbitration based upon the parties' contractual agreement to arbitrate. Thus, *Howells* is completely in accord with *Volt* because it stands for the principle that parties are bound by the terms of their arbitration agreements.

B. The Federal Cases Cited by Claimant are either Eclipsed by Volt or in Conflict with Illinois Law.

With one exception, the several federal cases cited by the Claimant in support of her FAA argument all suffer from the same flaw: they were all decided before the Supreme Court's decision in *Volt*, and accordingly do not follow the Supreme Court's emphasis on "effect[ing] . . . the contractual rights and expectations of the parties." *Volt*, 109 S.Ct. at 1256. Given that Claimant seeks to violate the Supreme Court's admonition by evading the plain language of her contract, it is no wonder that she finds it "surprising" that two recent Second Circuit opinions would reject F.A.A. preemption. *Fahnestock & Co., Inc. v. Waltman*, 935 F.2d (2d Cir. 1991); *Barbier v. Shearson Lehman Hutton, Inc.*, 948 F.2d 117 (2nd Cir. 1991) (Claimant's Brief at p. 19). The reason for the Second Circuit's

"surprising" conclusions, however, is obvious: the decisions were rendered after the Supreme Court's decision in *Volt*.

While Claimant's Memorandum highlights the case of *Doogle International, Inc. v. Stallmetal*, 84 Civ 7170 (S.D.N.Y. 1986), apparently an unpublished slip opinion decided years before Volt, the reasoning found in that opinion is completely eclipsed by *Volt*. Simply put, Judge Cannella would only allow the state's statute to control if it was *parallel* to an existing federal policy; *Volt* mandates that the state's statute should control unless it is *in conflict with* federal law. Additionally, Judge Cannella's 1984 opinion has been effectively overruled by his own Court of Appeal, which now takes the view of the F.A.A. mandated in *Volt*. *Fahnestock & Company, Inc. v. Waltman*, 935 F. 2d 512 (2nd Cir. 1991).

The one federal case cited by Claimant which was decided since *Volt*, *Pyle v. Securities U.S.A., Inc.*, 758 F. Supp. 638 (D.Colo. 1991), engages in "result-oriented reasoning" in the extreme by ruling that in the absence of an express agreement by the parties that state "arbitration law" should govern, state law such as *Garrity* does not apply. Even beyond the tortured reasoning used to avoid the Supreme Court's ruling in *Volt* (such as the creation from thin air of the vague term "arbitration law"), the *Pyle* case directly conflicts with the Illinois Appellate Court's decisions in *Mell v. Goodbody & Co.*, 10 Ill. App. 3d 809, 295 N.E.2d 97 (1st Dist. 1973) and *Yates v. Doctor's Associates, Inc.*, 193 Ill. App. 3d 431, 549 N.E.2d 1010, 140 Ill. Dec. 539 (5th Dist. 1990). In both *Mell* and *Yates* the courts found that where contract clauses which stated that the "agreement" and its "enforcement" should be

governed by state law, state law applied to all aspects of the arbitration. *In accord, Pierson v. Dean Witter Reynolds, Inc.*, 742 F.2d 334 (7th Cir. 1984). As noted by the *Yates* court, this conclusion is especially applicable when the same agreements contains a specific clause which calls for arbitration of disputes. 549 N.E.2d at 1015. In the case at bar, Paragraph 17 of the agreement between the parties states that "this Agreement *and its enforcement* shall be governed by the laws of the state of New York . . . ". (emphasis added). Paragraph 13 of the same Agreement mandates arbitration. Even if the controlling precedent of *Mell* and *Yates* did not exist, it would strain reason to interpret the Agreement as doing anything else but calling for application of New York "arbitration law", including *Garrity*.

II. CLAIMANT CANNOT BE HEARD TO ASSERT THAT NEW YORK'S BAR AGAINST PUNITIVE DAMAGES IN ARBITRATION IS A MINORITY VIEW, BECAUSE OTHER STATES APPLY THE SAME RULE.

Claimant's attack on *Garrity* as "widely criticized" is rebutted by the fact that at least five states bar punitive damages in arbitration, including the neighboring state of Indiana. See, *School City of East Chicago, Indiana, v. East Chicago Federation of Teachers*, 422 N.E.2d 656, 663 (Ind. App. 1981). *Miller v. Kingsley*, 230 N.W.2d 472, 474 (Neb. 1975); *Shaw v. Kuhnel & Associates, Inc.*, 698 P.2d 880, 882 (N.M.1985); *Barr v. Interbay Citizens Bank*, 635 P.2d 441 (Wash. 1981); *N.H.Rev. Stat.* §507.16 (1986). Approximately the same number allow arbitration panels to award punitive damages, and the rest have no decision.

This hardly makes *Garrity* the "repeatedly rejected" case asserted by the Claimant.

III. ARBITRATORS DO NOT HAVE THE POWER TO AWARD PUNITIVE DAMAGES AS ASSERTED BY THE CLAIMANT BECAUSE SUCH A POWER WOULD VIOLATE THE FEDERAL CONSTITUTION'S GUARANTEE OF DUE PROCESS OF LAW UNDER THE FOURTEENTH AMENDMENT.

Even if Claimant succeeds in ignoring the plain terms of her agreement, ignoring the plain language of judicial opinions from Illinois courts, the Seventh Circuit Court of Appeals and United States Supreme Court which hold her to her agreement, and ignoring the open hostility of Illinois law to punitive damages, any award of punitive damages in this arbitration would also violate the Respondents' rights of due process as articulated by the United States Supreme Court in *Pacific Mutual Life Insurance Co. v. Haslip*, ___ U.S. ___, 111 S.Ct. 1032, 113 L.Ed.2d 1 (1991). Due process standards are applicable to arbitration awards because in awarding damages arbitration panels usurp a "state function" under the principles enunciated in *Marsh v. Alabama*, 326 U.S. 501, 66 S.Ct. 276, 90 L.Ed. 265 (1946) and *Terry v. Adams*, 345 U.S. 461, 73 S.Ct. 809, 97 L.Ed. 452 (1953). In *Haslip*, the Supreme Court for the first time articulated the restrictions which due process places upon punitive damage awards. Arbitral punitive damages awards openly violate those restrictions.

In *Haslip*, an insurance company employee embezzled insurance premiums. The verdict against the insurance company included a one million dollar punitive

damages award. In deciding whether the award violated due process, the Court articulated three factors which were central to maintaining due process: control of the jury's exercise of discretion in deciding whether punitive damages should be awarded and in what amount, meaningful post-trial review of the merits of punitive damage awards by the trial court, and meaningful post-trial appellate review. None of these factors are present in arbitration.

A. Punitive Damages Awards in Arbitration are Unconstitutional Because of the Unbridled Discretion of the Arbitrators.

Due process is violated because the arbitrators receive no judicial instruction concerning the purposes and nature of punitive damages, then exercise unparalleled discretion in making an award. In the words of Justice Blackmun in the majority opinion in *Haslip*:

> One must concede that unlimited jury discretion – or unlimited judicial discretion for that matter – in the fixing of punitive damages may invite extreme results that jar one's constitutional sensibilities.

___ U.S. at ___, 111 S.Ct. at 1043. The Court found that Alabama's procedures did not create unlimited discretion because they "enlightened the jury as to the punitive damages nature and purpose, identified the damages as punishment for civil wrongdoing of the kind involved, and explained that their imposition was not compulsory." *Id.* at 1044.

No such instructions or reins on discretion are provided for N.A.S.D. arbitrators. Indeed, Claimant' Memorandum trumpets the argument that an arbitrator's power is completely unfettered.

Claimant will find no comfort in comparing a punitive damages award with an arbitration award of treble damages under the Racketeer Influenced Corrupt Organizations Act 18 U.S.C. 1961 *et seq.* (1988). If a RICO violation is found, the award of compensatory damages is trebled, a simple mathematical calculation mandated by law. The danger to due process caused by unfettered nonjudicial power to award unlimited amounts of punitive damages simply does not exist.

B. Punitive Damages are Unconstitutional Because the Arbitration Process Precludes Meaningful Review of an Arbitration Award by the Trial Courts Which Confirm the Award.

Arbitral punitive damages awards violate a respondents' right to due process because the respondent has no right to meaningful judicial review of the criminal punishment imposed by the private tribunal. In *Haslip*, the Supreme Court upheld the punitive damages award because Alabama law requires that the trial court judge must both approve the jury's award of punitive damages and articulate a basis for his approval of the award:

> Before trial in this case took pace, the Supreme Court of Alabama had established post-trial procedures for scrutinizing punitive damages award. In *Hammond v. City of Gladsden*, 493 So. 2d 1374 (1986), it stated that trial courts are "to reflect in the record the reasons for interfering

> with a jury verdict, or refusing to do so, on grounds of excessiveness of the damages". *Id.* at 1379. Among the factors deemed "appropriate for the trial court's consideration" are the "impact upon the parties," and "other factors, such as the impact on innocent third parties". *Ibid.* The *Hammond* test ensures meaningful and adequate review by the trial court whenever a jury has fixed the punitive damages.

___ U.S. at ___, 111 S.Ct. at 1044.

Illinois law does not require an explanation of the reasoning behind an award, and judicial review is quite limited. Under Illinois law, absent a requirement in the arbitration agreement, an arbitrator need only announce the award, and an explanation or findings are not required. *Wilcox co. v. Bourmas*, 73 Ill. App. 3d 1046, 392 N.E.2d 198, 29 Ill. Dec. 641 (1st Dist. 1979). Additionally, the Code of Arbitration Procedure makes no provision for explanations of findings in the awards rendered under Section 41.

Even beyond the fact that no written explanation of why punitive damages were awarded need be provided by the arbitrator, under Illinois law a Circuit Court's review of an arbitration award prior to confirmation is quite limited, and contains no review features such as the Supreme Court found important in *Haslip*. Under Section 41(b) of the Code of Arbitration Procedure, "[u]nless applicable law directs otherwise, all awards rendered pursuant to this Code shall be deemed final and not subject to review or appeal". Under the Illinois Arbitration Act, an award can be vacated for only five reasons:

(1) fraud or corruption; (2) evident partiality of an arbitrator; (3) the arbitrators exceeded their powers; (4) the arbitrators unreasonably refused to grant an adjournment, or otherwise so conducted the hearing as to prejudice the rights of one of the parties; or, (5) no agreement to arbitrate existed. *Ill. Rev. Stat.*, Ch. 10, para. 112 (1989). The federal Arbitration Act is parallel. 9 U.S.C. § 10 (1990). Moreover, an award cannot be set aside based on faulty reasoning by the arbitrator or because the arbitrator made mistakes of fact or law. *Wilcox Co., supra*, 392 N.E.2d at 202, 29 Ill. Dec. at 645. This is hardly the "meaningful and adequate review" contemplated by the Supreme Court.

C. Punitive Damages Awards in Arbitration are Unconstitutional Because of the Lack of Post-Award Appellate Review of the Decision in Illinois.

In *Halsip*, the Supreme Court found due process because the Alabama appellate courts closely review punitive damage awards rendered in the state courts:

> By its review of punitive awards, the Alabama Supreme Court provides an additional check on the jury's or trial court's discretion. It first undertakes a comparative analysis. [citation omitted]. It then applies the detailed substantive standards it has developed for evaluating punitive awards. In particular, it makes its review to ensure that the award does "not exceed an amount that will accomplish society's goals of punishment and deterrence." [citation omitted]. This appellate review makes certain that the punitive damages are reasonable in their

> amount and rational in light of their purpose to punish what has occurred and to deter its repetition.

Id.

Appellate review of arbitration awards, whether in Illinois or federal courts, is extremely limited. The very narrow review granted in confirmation proceedings in the trial court has been discussed *infra*. On appeal, judicial review is even more limited than appellate review of a trial court judgment. *American Ivsco Realty, Inc. v. Century 21*, 96 Ill. App. 3d 56, 420 N.E.2d 692, 51 Ill. Dec. 278 (1st Dist. 1981). A party seeking review must demonstrate one of the statutory bases for *vacatur* of the award, for judicial review of the merits of an award generally will not be had. *Board of Trustees of Junior College District No. 508 v. Cook County College Teachers Union*, 96 Ill. App. 3d 913, 422 N.E.2d 115, 52 Ill. Dec. 434 (1st Dist. 1981).

The combination of the limited review by the trial court and the even more limited review at the appellate level demonstrates the deprivation of due process of law: in awarding punitive damages in Illinois, the arbitration panel would usurp the police function of the state and impose non-compensatory punishment, but the defendant is afforded no meaningful opportunity to appeal his sentence. Conversely, the State of Illinois is afforded no meaningful control over the punishment meted out by a private tribunal. Barring punitive damages in arbitration would eliminate this entire problem.

D. Respondents have Not Waived their Right to Due Process of Law by contractually Agreeing to Arbitrate.

No waiver is present because the arbitration contract as bargained for by the Respondents applies New York law, which in turn bars punitive damages. Waiver of a constitutional protection requires a clearly enunciated waiver which is voluntarily, intelligently and knowingly made. *Fuentes v. Shevin*, 407 U.S 67, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972). In the case at bar, the Respondents bargained for and received a contract which by its terms applies a body of law which *rejects* punitive damages in arbitral awards; this conduct is completely inconsistent with a voluntary surrender of due process rights which restrict punitive damages. Thus, the waiver cannot be said to have been "voluntary".

Additionally, waiver cannot be found because the consequences of the waiver were not plainly presented to the Respondents at the time of the purported waiver. For example, at the time of entering a contract which they thought would *eliminate* punitive damages in arbitration, Respondents were not made aware that punitive damages would in fact be allowed, and that the imposition of punitive damages would be made without any judicially imposed criteria or restrictions whatsoever, and that review of the punitive damages awards would be virtually non-existent. Respondents cannot be said to have made a "knowing" or "intelligent" waiver of constitutional due process as is required by the United States Supreme Court.

CONCLUSION

This panel is asked to reject the Claimant's crude attempt to bludgeon this panel into making an award of punitive damages. The list of cases in which punitive damages were awarded is irrelevant, first because the facts and circumstances of those cases are unknown, and second because the issue of punitive damages in arbitration is one of law, and not custom and usage of arbitration panels. Claimant's federal case law is badly out of date, and the relevant citations from Illinois courts support the position of the Respondents, not the Claimant.

WHEREFORE, Respondents, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., LARRY H. LOVITSCH and THOMAS R. VALAIKA, request that this panel reject any claim for punitive damages in this arbitration.

Respectfully submitted,

MERRILL LYNCH, PIERCE,
FENNER & SMITH, INC.,
LARRY H. LOVITSCH and
THOMAS R. VALAIKA

By: /s/ Peter A. Cantwell
One of Their Attorneys

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IN ARBITRATION BEFORE THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

MARCIA M. ROUBIK, Claimant,	)	
v.	)	Claim No. 91-00169
MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., LARRY H. LOVITSCH and THOMAS R. VALAIKA, Respondents.	)	

SUPPLEMENTAL MEMORANDUM REGARDING PUNITIVE DAMAGES

NOW COME the Respondents, MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., THOMAS R. VALAIKA, and LARRY H. LOVITSCH, by and through one of their attorneys, and for their Supplemental Citation of Authority concerning the availability of punitive damages in arbitration under Illinois law, state as follows:

At the time that the briefs were submitted in this matter, there was no Illinois precedent ruling on the availability of punitive damages in arbitration. On May 7, 1992, the Illinois Appellate Court for the First District, Fourth Division, issued its opinion in *Edward Electric Company v. Automation, Inc., et al.*, ___ Ill. App. 3d ___, ___ N.E.2d ___ (consolidated Appeal Nos. 91-1630 and 91-1745), wherein the Illinois Appellate Court held that an award of punitive damages in arbitration is beyond

the powers of the arbitrators unless the arbitration agreement concerning the dispute "expressly" grants the arbitrators the power to award such damages. A copy of the Illinois Appellate Court's decision is attached hereto as Exhibit "A."

In summary, in *Edward Electric* the dispute arose from the construction of a package-handling and sorting system for an air freight company. Edward Electric was a subcontractor which sued the general contractor, as well as the air freight system for non-payment. The general contractor and the air freight system, exchanged cross-claims. The arbitrators' award provided for the air freight system to pay damages to both the general contractor and the subcontractor. Importantly, the award in favor of subcontractor Edward Electric included punitive damages in the amount of $150,000.00.

The victorious contractors filed a motion before the Circuit Court of Cook County, Illinois to confirm the award, while the air freight system filed a motion to vacate it. The Circuit Court vacated the award, and an appeal was taken.

The Appellate Court for the First District upheld the *vacatur* of the award of punitive damages, but ordered that the award be confirmed in all other respects. In reaching its decision on punitive damages, the Court noted that the issue of whether punitive damages could be awarded by an arbitration panel in Illinois was one of first impression (Slip. Op. at 18). The Court noted that three main approaches were identifiable in the treatment of the issue nationwide. The first view was that punitive damages were allowable unless the arbitration agreement specifically stated otherwise. The second view, with the leading opinion being *Garrity v. Lyle Stuart, Inc.*, 386

N.Y.S.2d 831, 353 N.E.2d 793 (1976), was that punitive damages, being a punishment imposed by the state, could not be awarded by a private arbitration tribunal. The third view was that punitive damages could be awarded only where there is "an express provision authorizing such relief in the arbitration agreement."

The Illinois Appellate Court adopted the third approach. The Court noted that Illinois law has long held that punitive damages are not favored and must be closely scrutinized (Slip. Op. at 19, *citing, Kelsay v. Motorola, Inc.*, 74 Ill. 2d 172, 188, 384 N.E.2d 353 (1987)). The Illinois Appellate Court also quoted extensively from the New York Court of Appeals *Garrity* opinion wherein it was stated that punitive damages in arbitration granted virtually unlimited power to the arbitrators without effective judicial supervision over that power. (Slip. Op. at 19-20). The Illinois Appellate Court concluded as follows:

> Although we recognize the dangers of allowing arbitrators to award punitive damages, we are not unmindful of the need for arbitrators to have the power to award full and complete relief if arbitration is to serve as an effective substitute for litigation. We therefore conclude that punitive damages may be awarded in arbitration, but only where the parties have expressly agreed to the arbitrators' authority to award punitive damages.
>
> In the case at bar, the arbitration agreement does not expressly provide the arbitrators with the authority to award punitive damages. The basis for the award was [the subcontractor's] request for punitive damages in count IV of its arbitration claim. We do not believe that this was sufficient to satisfy the requirement of an express agreement between the parties that punitive

> damages were within the authority of the arbitrators. Therefore, we vacate the award of $150,000.00 in punitive damages contained in paragraph 3 of the arbitration award.

(Slip. Op. at 20-21). Accordingly, the Illinois courts have now spoken concerning the availability of punitive damages in arbitration proceedings.

In the case before this Panel, not only does the arbitration agreement between the parties fail to expressly authorize punitive damages, it in fact does quite the opposite. The arbitration agreement invokes New York law concerning the arbitration process, a body of law which expressly rejects the punitive damage awards in arbitration. Thus, whether the applicable law is that the forum, Illinois, or that expressly called for in the arbitration agreement, New York, punitive damages are not available to the Claimant in this arbitration proceeding.

Respectfully submitted,

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., THOMAS R. VALAIKA and LARRY H. LOVITSCH

By: /s/ Peter A. Cantwell
One of their attorneys

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IN ARBITRATION BEFORE THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

MARCIA M. ROUBIK, Claimant,	)	
v.	)	Claim No. 91-00169
MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., LARRY H. LOVITSCH and THOMAS R. VALAIKA, Respondents.	)	

CLAIMANT'S REPLY TO RESPONDENTS' SECOND SUPPLEMENTAL MEMORANDUM REGARDING PUNITIVE DAMAGES

ON THE FACTS OF THIS CASE, THE EDWARD ELECTRIC "REQUIREMENT" HAS BEEN MET

Even if Edward Electric Co.[1] were controlling precedent[2] it would not prohibit the arbitration panel from awarding punitive damages in this claim. The uncontestable fact is that unlike *Edwards Electric*, Respondents have *expressly* authorized this arbitration panel to hear and resolve the claim for punitive damages as set forth in the Statement of Claim filed with the NASD in January of

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[1] *Edward Electric Co. v. Automation, Inc., et al.*, ___ Ill. App. 3d ___, ___ N.E.2d ___ (1992).

[2] *See* discussion *infra*, pages 2-5.

1991. On April 3, 1991, all Respondents executed a Submission Agreement for this arbitration which without reservation or limitation, at paragraph 1, states:

> "The undersigned parties *hereby submit the present matter in controversy, as set forth in the attached statement of claim,* answers, crossclaims and all related counterclaims and/or third party claims which may be asserted, *to arbitration* in accordance with the Constitution, By-Laws, rules, regulations and/or Code of Arbitration Procedure of the sponsoring organization." (emphasis added)

Not even these Respondents can dispute that the Statement of Claim filed with the NASD on January 15, 1991 and accepted by the NASD as arbitrable contained a clear statement of the claim for punitive damages and that by executing the Submission Agreement the Respondents expressly agreed to submit the claim of punitive damages as well as all other claims stated in the Statement of Claim to this arbitration panel for decision. Accordingly, the "requirement" of *Edward Electric* for a written agreement to arbitrate this issue has been met.

The arbitration panel should also note that if *Edward Electric* means, as Respondents contend, that unless specifically expressed in the original customer agreement, the panel has no authority to hear the matter, then, likewise, the panel has no authority to hear the issues raised by Respondents' affirmative defenses, i.e., estoppel, ratification, negligence, mitigation, laches and the statute of limitations. The customer agreement is silent with respect to all of these issues. As a consequence, under *Edward*

Electric, as read by Respondents, the panel has no authority to resolve any of these issues either. Fortunately, because the Federal Arbitration Act[3] and the cases decided under the Act are controlling, *Edward Electric* does not lead to the kind of absurd restraint Respondents seek to impose on the authority of the arbitration panel and upon Claimant's right to claim punitive damages in this or other proceedings.

FEDERAL SUBSTANTIVE LAW OF ARBITRABILITY SUPERCEDES AND IS ENFORCEABLE IN STATE AND FEDERAL COURTS REGARDLESS OF STATE LAW OR PROCEDURAL POLICY TO THE CONTRARY

Respondents' most recent citation and memorandum fails to recognize that the *Edward Electric* decision does not reach the issue presented by this claim, i.e., when an arbitration agreement is contained in a contract evidencing transactions in interstate commerce, whether the Federal Arbitration Act governs to the exclusion of state law to the contrary. From a reading of *Edward Electric* it is abundantly clear that the applicability and the effect of the Federal Arbitration Act was not raised, argued or considered.

In the one Illinois case which has been located that does bear on this issue, *Howells v. Hoffman*, 154 Ill. Dec. 713, 568 N.E.2d 934 (Ill. App. 3d Dist. 1991), the court held:

> "It is well established that where an arbitration agreement is contained within a contract

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[3] 9 U.S.C. § 1, *et seq.*

> evidencing a transaction involving commerce, the Federal Arbitration Act ("FAA") ([sic] 9 U.S.C., § 2 (1982) governs to the exclusion of state law. (See *Gelderman, Inc. v. Stathis* (1988), 177 Ill. App. 3d 414, 532 N.E.2d 366, 126 Ill. Dec. 681.) There is no dispute that the transactions herein involved interstate and not intrastate commerce."

The arbitration panel should note that in the Howells case, it was a Merrill Lynch account executive who successfully maintained that the Federal Arbitration Act governed to the exclusion of state law.

In *Perry v. Thomas*, 42 U.S. 483, 107 S.Ct. 2520, 96 L.E.2d 426 (1987), the Supreme Court ruled that Section 2 of the Federal Arbitration Act created a body of federal substantive law of arbitrability which was enforceable in both state and federal courts even if there is state substantive or procedural policy to the contrary. *See also Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984), and *Moses H. Cohen Memorial Hospital v. Mercury Corp.*, 460 U.S. 1, 103 S.Ct. 927, 74 L.E.2d 765 (1983) (once it is determined that a dispute is covered by the Act "federal substantive law as set forth in the Act and the case law interpreting the Act governs the scope and interpretation of the agreement"). In *Willis v. Shearson/American Express, Inc.*, 569 F.Supp. 821 (N.D.N.C. 1983), the court held in part:

> "In any event, the law is quite clear that under the Federal Arbitration Act . . . arbitration clauses should be read broadly and arbitration should not be denied in the absence of clear and express *exclusions*." (emphasis added)

See also, Willoughby Roofing and Supply Co. v. Kajima International, Inc., 598 F.Supp. 353 (N.D.Ala. 1984), *aff'd on opinion below*, 776 F.2d 269 (11th Cir. 1985), *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378 (11th Cir. 1988), *Raytheon v. Automated Business Systems, Inc.*, 882 F.2d 6 (1st Cir. 1989); *Pyle Securities U.S.A., Inc.*, 758 F.Supp. 638 (D.C. Colo. 1991), and the discussion regarding the above cases in Claimant's original memorandum in support of the authority of the arbitration panel to award punitive damages dated January 16, 1991 at pages 12 through 21. *See also* discussion of the relevant regulatory and judicial policies at pages 21-25.

RESOLUTION OF THE SCOPE OF THE ARBITRATION PANEL'S AUTHORITY IS NOT THE SAME AS A SUBSTANTIVE RULING ON THE MERITS OF THE CLAIM FOR PUNITIVE DAMAGES

As the court in *Raytheon, supra,* pointed out:

> "Where such conduct could give rise to punitive damages if proved to a court, there is no compelling reason to prohibit a party which proves the same conduct to a panel of arbitrators recovering the same damages. Certainly, the fact that the parties agreed to resolve their dispute through an expedited and less formal procedure *does not mean* that they each should be required to surrender a legitimate claim for damages.[4] (emphasis added)

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[4] 882 F.2d 12.

As Claimant has previously asserted,[5] were the panel to conclude: that the customer agreement was not an agreement evidencing transactions in interstate commerce, that the Federal Arbitration Act was not applicable, that the plain meaning of the Submission Agreement does not include the claim for punitive damages and rule that regardless of the merits of the claim, the panel does not have the authority to make an award of punitive damages, the correct procedure, as has been done with other non-arbitrable claims such as Federal Securities Act claims,[6] is to without prejudice, split off the non-arbitrable claim and pursuant to Section 16 of the Code of Arbitration Procedure refer the parties to the remedies provided by applicable law through the judicial system.

CONCLUSION

For all of the foregoing reasons and for the reasons set forth in Claimant's initial memorandum and supplemental memorandum, Claimant respectfully requests that this panel exercise its authority to award punitive damages in the final award in this claim.

Respectfully submitted,

MARCIA M. ROUBIK

By: /s/ Paul D. Carrier
Paul D. Carrier
One of Her Attorneys

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[5] *See* Claimant's memorandum dated January 16, 1992 at pages 25 and 26 and the authorities cited therein.

[6] *See Hagstrom v. Breutman*, 580 F.Supp. 773 (D.C. N.D. Ill. 1984).

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CERTIFICATE OF SERVICE

The undersigned attorney certifies that the original of this Claimant's Reply to Respondents' Second Supplemental Memorandum Regarding Punitive Damages was served upon the Respondents in this matter by causing said Reply to be mailed first class, postage prepaid, to: Peter A. Cantwell, Esq., Cantwell and Cantwell, 30 North LaSalle Street, Suite 2424, Chicago, Illinois 60602; and that he has caused a copy of this document to be filed with the Director of Arbitration for the National Association of Securities Dealers, Inc. by hand-delivering a copy of this document to: The Director of Arbitration, National Association of Securities Dealers, Inc., 10 South LaSalle Street, 20th Floor, Chicago, Illinois 60603, Attn: William B. Kimme, Esq., this 29th day of June, 1992.

/s/ Paul D. Carrier
Paul D. Carrier
Attorney for Claimant

STATUTORY PROVISIONS INVOLVED

Section 9 of the Federal Arbitration Act, 9 U.S.C. § 9 (1996), provides as follows:

> If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified or corrected as prescribed in sections 10 and 11 of this title. If no court is specified in the agreement of the parties, then such application may be made to the United States court in and for the district within which such award was made. Notice of the application shall be served upon the adverse party, and thereupon the court shall have jurisdiction of such party as though he had appeared generally in the proceeding. If the adverse party is a resident of the district within which the award was made, such service shall be made upon the adverse party or his attorney as prescribed by law for service of notice of motion in an action in the same court. If the adverse party shall be a nonresident, then the notice of the application shall be served by the marshal of any district within which the adverse party may be found in like manner as other process of the court.

Section 10 of the Federal Arbitration Act, 9 U.S.C. § 10 (1996), provides as follows:

> (a) In any of the following cases the United States court in and for the district wherein the award

was made may make an order vacating the award upon the application of any party to the arbitration –

(1) Where the award was procured by corruption, fraud, or undue means.

(2) Where there was evident partiality or corruption in the arbitrators, or either of them.

(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

(5) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.

(b) The United States district court for the district wherein an award was made that was issued pursuant to section 580 of title 5 may make an order vacating the award upon the application of a person, other than a party to the arbitration, who is adversely affected or aggrieved by the award, if the use of arbitration or the award is clearly inconsistent with the factors set forth in section 572 of title 5.

Section 11 of the Federal Arbitration Act, 9 U.S.C. § 11 (1996), provides as follows:

> In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration –
>
> (a) Where there was an evident material miscalculation of figures or any evident material mistake in the description of any person, thing, or property referred to in the award.
>
> (b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.
>
> (c) Where the award is imperfect in matter of form not affecting the merits of the controversy.
>
> The order may modify and correct the award, so as to effect the intent thereof and promote justice between the parties.